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United States
Circuit Court of Appeals

For the Ninth Circuit.

Vol
2313

KENNETH R. GREENWOOD, Administrator of
the Estate of Charles H. Greenwood, Deceased,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the United States
Board of Tax Appeals

FILED

SEP 25 1942

PAUL P. O'BRIEN,

United States
Circuit Court of Appeals
For the Ninth Circuit.

KENNETH R. GREENWOOD, Administrator of
the Estate of Charles H. Greenwood, Deceased,
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

JOHN M. SCHWARTZ, Esq.,

For Comm'r.:

FRANK T. HORNER, Esq.,

R. C. WHITLEY, Esq.

Docket No. 104987

ESTATE OF CHARLES H. GREENWOOD,
Deceased, KENNETH R. GREENWOOD,
Administrator,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1940

Sep. 27—Petition received and filed. Taxpayer notified. Fee paid.

“ 27—Copy of petition served on General Counsel.

Nov. 25—Answer filed by General Counsel.

“ 25—Request for hearing in Los Angeles filed by General Counsel.

“ 29—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.

1940

Dec. 10—Stipulation correcting amount of deficiency as disclosed in 90 day letter attached to petition filed.

1941

May 19—Deposition of Mrs. Albertine Greenwood filed. General Counsel and taxpayer served by notary.

Jul. 15—Hearing set Sept. 22, 1941 in Los Angeles, Calif.

Sep. 23—Hearing had before Mr. Disney on merits. Deposition of Mrs. Albertine Greenwood received and made a part of record. Briefs due 10/23/41—replies 11/7/41.

Oct. 3—Transcript of hearing of Sept. 23, 1941 filed.

“ 20—Brief filed by taxpayer. 10/22/41 copy served.

“ 22—Brief filed by General Counsel.

Nov. 7—Reply brief filed by taxpayer. 11/7/41 copy served.

1942

Apr. 3—Findings of fact and opinion rendered, Disney, Div. 4.

Decision will be entered under Rule 50. 4/4/42 copy served.

“ 21—Computation of deficiency filed by General Counsel.

“ 22—Hearing set May 20, 1942 on settlement.

May 4—Motion for reconsideration and vacate its decision filed by taxpayer. 5/5/42 denied.

“ 20—Hearing had before Mr. Murdock on set-

1942

tlement under Rule 50. Respondent's computation not contested. Referred to Mr. Disney for decision.

May 29—Decision entered, R. L. Disney, Div. 4.

Jun. 29—Petition for review by U. S. District Court of Appeals, 9th Circuit, filed by taxpayer.

Jul. 13—Proof of service filed by taxpayer.

“ 30—Statement of points filed by taxpayer.

“ 30—Designation of record filed by taxpayer with proof of designation and statement of points thereon. [1*]

United States Board of Tax Appeals

Docket No. 104987

ESTATE OF CHARLES H. GREENWOOD,
Deceased, KENNETH R. GREENWOOD,
Administrator,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

Comes now the above named petitioner and hereby petitions for a redetermination of the deficiency

*Page numbering appearing at top of page of original certified Transcript of Record.

set forth by the respondent in his notice of deficiency dated the 22nd day of July, 1940, and herein petitioner alleges:

I.

That petitioner is the Estate of Charles H. Greenwood; that the said Charles H. Greenwood died testate on the 21st day of July, 1939, a resident of the county of Pima, state of Arizona; that Kenneth R. Greenwood of 1616 East 6th Street, Tucson, Arizona, was regularly appointed administrator of said estate and is now the duly appointed, qualified and acting administrator with-will-annexed of said estate; that the estate tax return in the matter involved herein was regularly filed with the Collector of Internal [2] Revenue, District of Arizona.

II.

That the notice of deficiency was mailed to petitioner on the 27th day of July, 1940; that a copy thereof is attached hereto marked "Exhibit A".

III.

That the taxes in controversy are federal estate taxes and that while respondent alleges a deficiency of \$18,501.28, the amount in controversy is approximately \$17,820.79.

IV.

That the respondent erred in his determination of said deficiency, specifically as follows:

Assignment of Error No. 1.

The respondent erred in finding that the

stocks, bonds, mortgages, notes, cash, and miscellaneous property, the valuation of which is shown on pages 2 and 3 of Exhibit A, was the separate property of Charles H. Greenwood and not the common or community property of said Charles H. Greenwood and his wife, because said property was owned by said Charles H. Greenwood and his wife equally at the time of his death and for many years prior thereto.

Assignment of Error No. 2.

The respondent erred in concluding that the whole of the value of the stocks, bonds, mortgages, notes, cash, and miscellaneous property shown on pages 2 and 3 of Exhibit A was taxable to petitioner, because one-half thereof was owned by the wife of said Charles H. Greenwood at the time of his death. [3]

IV.

That the facts upon which petitioner relies to sustain the foregoing assignments of error are as follows:

1. That the said Charles H. Greenwood and Albertine Greenwood were husband and wife at the time of the death of Charles H. Greenwood on the 21st day of July, 1939, and for many years prior thereto; that in or about the year 1927 they moved to the state of Arizona and from that time to the date of the death of the said Charles H. Greenwood they were bona fide residents of that state; that during most of the years of their mar-

ried life prior to the year 1927 they were residents of the state of New York.

2. That at the time of the death of said Charles H. Greenwood, he and the said Albertine Greenwood held property of the value of \$251,966.58; that of said property, property of the value of \$16,360.38 was the separate property of the said Charles H. Greenwood and at the time of his death was held in a trust created by him on or about the 2nd day of November in the year 1928; that the rest of said property, consisting of real estate, stocks, bonds, mortgages, notes, cash, and miscellaneous property, the value of which is shown on pages 2 and 3 of Exhibit A and aggregates \$235,606.20, was at said time the common and community property of the said Charles H. Greenwood and the said Albertine Greenwood.

3. That said property of the value of \$235,606.20 was acquired by the said Charles H. Greenwood and Albertine Greenwood by and through their joint efforts during the period of their marriage.

[4]

4. That at or about the time they became residents of the state of Arizona, and on occasions too numerous to mention thereafter, the said Charles H. Greenwood and the said Albertine Greenwood, cognizant of the community property laws of the state of Arizona, discussed their respective property interests and mutually agreed and understood that all property accumulated by them during their marriage, except that set aside in trust as the separate property of Charles H. Greenwood, was, and should

be, the common property of both and that such property should assume, and did assume, the nature of community property acquired by husband and wife by joint effort while domiciled in the state of Arizona; that pursuant to said agreement and understanding the said Charles H. Greenwood and the said Albertine Greenwood, at all times during their period of residence in the state of Arizona as husband and wife, mutually observed an equality of interest in all such property; that they maintained during said time a joint safe deposit box in which they kept all their securities and valuable papers, and access to which was enjoyed without restriction by each of them; that the stocks, bonds, mortgages, notes, and deeds to the real estate, the values of which are set forth on pages 2 and 3 of Exhibit A, were held by the said Charles H. Greenwood and said Albertine Greenwood in said safe deposit box at the time of his death on the 21st day of July, 1939; that the bank through which they transacted business in the city of their residence at the time of the death of said Charles H. Greenwood was the Southern Arizona Bank & Trust Company of Tucson; that all of the money on deposit by [5] them, or either of them, in said bank at said time was in accounts standing in both their names; that all of said property of the value of \$235,606.20 was the common and community property of the said Charles H. Greenwood and the said Albertine Greenwood at all times after its acquisition subsequent to the time they became bona fide residents of the state of Arizona.

5. That within the time prescribed by law the said Kenneth R. Greenwood, as administrator with-the-will-annexed of the estate of Charles H. Greenwood, deceased, filed with the Collector of Internal Revenue at Phoenix, Arizona, an estate tax return on which was shown a total gross estate of \$128,-658.69; that thereafter certain changes in valuation were made by the respondent as indicated on pages 2 and 3 of Exhibit A; that the total gross estate should have been shown on said return as \$134,-163.48.

Wherefore petitioner prays that the determination of the respondent be reversed and set aside and that petitioner's estate tax liability be determined in accordance with the facts herein set forth.

JOHN M. SCHWARTZ

Attorney for Petitioner.

215 West 7th Street,

Los Angeles, California. [6]

(Duly verified.) [7]

EXHIBIT A

Treasury Department

Internal Revenue Service

Los Angeles, California

Jul 27 1940

Office of

Internal Revenue Agent in Charge

Los Angeles Division

Estate of Charles H. Greenwood, Deceased,

Kenneth R. Greenwood, Administrator,

1616 East 6th Street,

Tucson, Arizona.

Sir:

You are advised that the determination of the estate-tax liability of the above-named estate, discloses a deficiency of \$16,823.49, as shown in the statement attached.

In accordance with the provisions of existing internal-revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California for the attention of the Estate Tax Group Chief. The signing and filing of this form will expedite the closing of your return by permitting an early assignment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after filing

the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By (Signed) George D. Martin

Internal Revenue Agent in

Charge.

Enclosures:

Statement.

Form of waiver. [8]

MT-ET-Arizona

Estate of Charles H. Greenwood

Date of death—July 21, 1939

STATEMENT

The deficiency results from the following adjustments:

GROSS ESTATE

Real Estate	Returned	Tentatively Determined	Determined
Item 1,.....	\$ 6,000.00	\$12,000.00	\$ 6,000.00
“ 2,.....	2,500.00	5,000.00	2,500.00
Stocks and Bonds			
Item 1,.....	2,205.00	2,200.00	2,200.00
Interest,	0.00	24.44	24.44
“ 2,.....	1,025.00	1,100.00	1,100.00
5,.....	602.50	605.00	605.00
6,.....	1,027.50	1,022.50	1,022.50
Interest	0.00	35.00	35.00
7,.....	1,710.00	1,705.00	1,705.00
Interest	0.00	4.93	4.93
8, “	0.00	27.50	27.50
9, “	0.00	46.67	46.67
10,.....	4,565.00	4,570.00	4,570.00
Interest	0.00	8.76	8.76

Stocks and Bonds	Returned	Tentatively Determined	Determined
11, Interest.....	0.00	24.44	24.44
18,.....	118.75	881.25	881.25
19,.....	119,600.00	128,800.00	128,800.00
21, Dividend.....	0.00	9.60	9.60
23,.....	887.50	875.00	875.00
24,.....	643.50	646.75	646.75
25,.....	0.00	37.50	37.50
28,.....	0.00	600.00	600.00
Unchanged items	46,803.55	46,803.55	46,803.55
<hr/>			
Total.....	179,188.30	190,027.89	190,027.89
Less one-half community	89,594.15	0.00	0.00
<hr/>			
	89,594.15	190,027.89	190,027.89
Mortgages, Notes and Cash			
Travelers' checks	0.00	170.00	170.00
Unchanged items	26,708.31	26,708.31	26,708.31
<hr/>			
Total.....	26,708.31	26,878.31	26,878.31
Less one-half community	13,354.15	0.00	0.00
<hr/>			
	13,354.16	26,878.31	26,878.31
Other Miscellaneous Property			
Item 1,.....	350.00	700.00	700.00
“ 3,.....	500.00	1,000.00	1,000.00

In view of the foregoing, the Federal estate tax liability of this estate is finally determined as follows:

	Determined
Gross estate	\$243,466.58
Deductions (1926 Act).....	120,966.13
<hr/>	
Net estate (1926 Act).....	122,500.45

MT-ET-Arizona

Estate of Charles H. Greenwood

Date of death—July 21, 1939

GROSS ESTATE (Cont'd.)

	Determined
Gross estate	\$243,466.58
Deductions (1935 Act).....	60,966.13
Net estate (1935 Act).....	182,500.45
Gross tax, 1926 Act.....	\$ 2,175.01
Credit for State estate, inheritance, legacy or succession taxes.....	62.22
Net tax, 1926 Act.....	2,112.79
Total gross taxes, 1926 and 1935 Acts	23,625.07
Gross tax, 1926 Act.....	2,175.01
Net additional tax.....	21,450.06
Net tax, 1926 Act.....	2,112.79
Total net tax.....	23,562.85
Tax shown on return.....	5,061.57
Deficiency	\$ 18,501.28

The deficiency bears interest at the rate of six per cent per annum from fifteen months after the decedent's death to the date of assessment, or to the thirtieth day after the filing of a waiver of the restrictions on the assessment, whichever is the earlier.

Upon receipt of a waiver or upon the expiration of ninety days from the date of this letter, if a petition is not filed with the Board of Tax Appeals, \$16,823.49 of the deficiency will be assessed. [10]

As the balance of the deficiency may be eliminated by credit for State or Territorial estate, inheritance,

legacy or succession taxes, opportunity will be accorded for the submission of the evidence required by Article 9 of Estate Tax Regulations 80. If, after a reasonable time the evidence is not filed, the balance of the deficiency will be assessed. Please advise when the submission of this evidence may be expected.

A copy of this letter and statement has been mailed to your representative, John M. Schwartz, A. G. Bartlett Building, 215 East Seventh Street, Los Angeles, California, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

[Endorsed]: U.S.B.T.A. Filed Sept. 27, 1940.

[11]

[Title of Board and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits, denies and avers as follows:

I, II, III

Admits the allegations contained in paragraphs I, II and III of the petition.

IV

Denies the allegations of error contained in paragraph IV of the petition.

IV 1

Admits so much of subdivision 1 of paragraph IV of the petition as alleges that the decedent and Albertine Greenwood were husband and wife at the time of the death of Charles H. Greenwood on the 21st day of July, 1939, and that during most of the years [12] of their married life they were residents of the State of New York, and denies all other allegations therein contained.

IV 2, 3, 4

Denies the allegations contained in subdivisions 2, 3 and 4 of paragraph IV of the petition.

IV 5

Admits the allegations contained in subdivision 5 of paragraph IV of the petition except that it is denied that the total gross estate should have been shown on said return as \$134,163.48.

V

Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

VI

Avers that the deficiency determined by the Commissioner in this case amounts to \$18,501.28, as shown on page 3 of the deficiency notice, instead of \$16,823.49 as set forth in line 2, page 1, of the deficiency notice.

The facts upon which the respondent relies to support his averment, as set forth in paragraph VI hereof, are as follows:

(a) Upon the basis of the respondent's determined gross tax under the Revenue Act of 1926, the estate appears to be entitled to a credit for state estate, inheritance, legacy, or succession taxes, in the amount of \$1,740.00, provided proof [13] required by the Revenue Act and Regulations be submitted by the estate to the respondent. Of the said amount of credit to which the estate appears to be entitled, under the circumstances just recited, the respondent allowed as a credit the sum of \$62.22, leaving \$1,677.78 as a possible credit. The difference between the correctly determined deficiency of \$18,501.28 and the credit to which the estate may be entitled, is \$16,823.49, which last-mentioned amount was inadvertently entered on page 1 of the deficiency notice as the deficiency.

Wherefore, it is prayed that the Commissioner's determination be approved and that the amount of the deficiency determined by the respondent be found by the Board in the amount of \$18,501.28.

(Signed) J. P. WENCHEL,

FTH

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

FRANK T. HORNER,

Special Attorneys,

Bureau of Internal Revenue.

FTH/q 11-20-40.

[Endorsed]: U.S.B.T.A. Filed Nov. 25, 1940.

[Title of Board and Cause.]

Docket No. 104987. Promulgated April 3, 1942

FINDINGS OF FACT AND OPINION

Held, that separate property was not transmuted into community estate by oral agreement between husband wife, under the law of Arizona.

John M. Schwartz, Esq., for the petitioner.

Frank T. Horner, Esq., for the respondent.

This proceeding involves Federal estate tax liability. The deficiency determined (as corrected by stipulation) is in the amount of \$18,501.28. The issue presented is whether husband and wife, constituting a marital community in Arizona, by oral understanding transmuted separate property into community estate.

From allegations admitted in the pleadings and evidence adduced, we make the following findings of fact.

FINDINGS OF FACT

The estate tax return involved herein was filed with the collector of internal revenue for the district of Arizona, by the duly qualified administrator with will annexed of the estate of Charles H. Greenwood, who died testate on July 21, 1939. The decedent and Albertine Greenwood were married about 1899, and resided during the greater part of their married life in the State of New York.

For about 25 years decedent was employed by the Carborundum Co. at Niagara Falls, New York.

During the last ten years with that company he was general manager at a salary of \$15,000 per year. About 1922, because of the condition of the health of decedent's son, the son and decedent's wife moved to Tucson, Arizona. The decedent remained in Niagara Falls, retaining his position with the Carborundum Co. and making frequent visits to his wife and son in Arizona from about 1922 until 1927. In January or February 1927, decedent inherited some property from his mother. The record does not show the amount of the inheritance, but it was "fairly sizeable", in the language of decedent's widow. In March 1927 he retired, resigning [15] his position with the Carborundum Co. and went to Arizona. Thereafter the decedent, his wife, and his son lived together at Tucson, Arizona, until the time of his death. He remained retired and did not engage in any occupation, profession or business until his death, but lived upon his investments and income from the time he went to Arizona. He established bank accounts prior to his retirement in Massachusetts, to which accounts his wife made no contribution. He also established bank accounts in Arizona in which the wife made no deposits. These consisted of a savings account in a bank at Phoenix, Arizona, and a savings account and a checking account in a bank at Tucson, Arizona. Upon the accounts in Tucson either the petitioner or his wife could draw. Both signed the signature cards for both accounts, and on the card for the checking account the bank was

specially authorized in writing by the decedent to accept the endorsement of his wife upon all checks made to him personally for deposit. The checking account, established in 1928, was to the credit of "Greenwood, C. H., or Albertine, Either or Survivor of Either." Dividends from stock in the Carborundum Co. were deposited in the checking account and C. H. Greenwood checked upon that account in buying stocks up to the time of his death. In addition, a safe deposit box was in 1928 rented from the bank under a contract signed by both husband and wife and reciting in part:

We, the undersigned, joint renters of the above numbered Safe Deposit Box from the Southern Arizona Bank & Trust Company, (hereinafter called the Bank) hereby declare and represent that we own as joint tenants, with the right of survivorship, all the property of every kind or character now within said box and that all property which may be deposited therein by either or any of us shall be and is owned by us as such joint tenants.

We, jointly and severally, authorize the Bank to grant access to said Box, to either or any of us or the duly appointed deputy of either or any of us and we hereby expressly agree that the Bank is authorized to permit the surrender of the box and or the removal of the entire contents thereof, by either or any of us without notice to the others or to the survivor of us.

And we hereby, jointly and severally, for ourselves, our executors, administrators and assigns

hereby bind and obligate ourselves to indemnify, protect and save the Bank harmless from any loss, claims or damage it may be caused, or any expense of any kind or character it may or shall be compelled to incur by reason of its reliance in and acting upon the declarations and representations herein contained in granting access to and the removal of the contents of said box by either or any of us or the duly appointed deputy of either or any of us or by the survivor.

The undersigned in consideration of the letting of the above numbered safe deposit box by the Bank acknowledge receipt of two keys thereto and certify that they have read, received a copy and approve of the Bank's rules governing safe deposit boxes as printed on the reverse hereof and do hereby adopt and accept said rules and conditions as part of this rental contract.

1. Signature C. H. GREENWOOD.

2. Signature ALBERTINE GREENWOOD.

[16]

At the date of the death of the decedent the safety deposit box contained the assets, securities, and other documents of title and certificates evidencing the stocks and bonds held by the decedent at the time of his death and listed on the estate tax return filed. Of the assets so listed, valued in the return at \$240,956.99, the sum of \$179,188.-30 represented stocks and bonds, and \$26,708.31 represented deposits in bank, of which \$4,320.01 was in the savings account in the Tucson, Arizona,

bank in the name of "Greenwood, C. H., or Albertine", \$3,553.52 was in the checking account in the name of Greenwood, C. H., or Albertine, Either, or Survivor of Either" above referred to, and the remainder, \$18,834.78, represented savings accounts in decedent's name in cities in Massachusetts; Los Angeles, California; and Phoenix, Arizona.

The decedent allowed his wife \$200 per month for household and personal expenses. He paid this amount to her when he was at home, and when he was out of the city, the wife customarily issued checks upon the account, ordinarily to the extent of \$200 per month. At one time she paid hospital and other bills out of the amount, while her husband was in South America. She also in his absence paid premiums on her husband's life insurance policy out of the checking account.

At the time of the marriage of decedent and his wife, neither had any property, and with the exception of the inheritance from the decedent's mother in 1927, and \$1,000 inherited by the wife about 1937, the decedent's earnings constituted the income of the husband and wife. The wife was not engaged in any occupation or business, except that of a housewife. She deposited the \$1,000 which she inherited in her own name and the amount was still on deposit in her name at the bank at the time of the hearing. She at one time had some stock in a railroad company, about 10 shares, which she acquired with money she had saved out of the \$200 monthly allowance. The stock was later sold by

her husband in her absence. He put the money in stock of the American Woolen Co., in his own name. The dividend checks came to him. The dividends received thereon were sometimes kept by the husband and sometimes turned over to the wife. The husband always received the other income, including his salary, and handled it without control by the wife. She never received or requested an accounting from him. Although she had a key to the safety deposit box, she never went to the safety deposit box and never saw the contents thereof. She had seen some stocks and bonds and had had some in her hands, but all were in the name of the husband. The decedent never discussed tax returns with her, although he prepared and filed returns for both husband and wife, and told her he was so doing. [17]

In a general way the husband and wife discussed their property relations. He consulted her when real estate was bought, but there was no specific occasion upon which property was discussed. He always spoke of his property as being half hers and always referred to the fact that half of everything he had was hers. He used the expression community property, and always referred to the property as community property. It was her understanding that half of the ownership of the bank accounts was hers, that understanding being based upon different things that he told her.

The wife had a general knowledge of the stocks and bonds owned by her husband. She did not

know whether he had ever put any stock or bonds in her name. Their home when they lived in New York was in the name of both husband and wife, but, aside from that home and the bank accounts in Tucson, Arizona (and real estate in Arizona, and in the name of both and not herein involved), all **other forms of property** were carried by the husband in his own name. He never asked her opinion, permission, or advice about making sales or changes in the property. About a year before he died, the husband told the wife she was worth one-half of what he was worth, but she never had any written communication or document on the subject. Neither husband nor wife signed any written statement. He received his income from all sources and disposed of it as he saw fit. Once when the husband and wife had a disagreement, about a year before he died, he made the remark, "Well, half of everything I have is yours." He made that statement several times. He prepared the income tax returns for both, but she signed her own and he signed his. Her income as returned was slightly less than his. The conversations about community property and her interest were only occasional and the subject was not referred to often.

The decedent stated to an intimate friend while automobile riding in 1936 that one-half of all of his property belonged to his wife, that they had split everything they had fifty-fifty. On another occasion in 1938, in the course of a family argument the wife said to her husband in the presence

of the friend: "You know, Charles, that one-half of all we own belongs to me", and the husband stated: "That is correct, I know it as well as you do." In 1938 the decedent stated to the same friend that his wife was ill and that he wanted a will prepared so that if she passed away her community interest would not pass to the son, which would be embarrassing to him, and that he would like to have a will so that she could give her half to him, the decedent. At the date of decedent's death, his wife's will provided that all of her property go to him; and his will left [18] all of his property, except a certain trust estate not here involved, to his wife.

The son as administrator returned the property upon the Federal estate tax return as community property for the reason that his father always stated that he had believed that one-half of the property was his and one-half belonged to the wife, and the son wished to carry out his ideas in the administration of the estate. The estate tax return showed, as the separate property of the decedent, a trust estate of \$16,360.38.

In determining the deficiency in estate tax herein, the Commissioner, with certain exceptions not material, computed gross estate without allowing a deduction of one-half as set up in the return under the claim of community property.

OPINION

Disney:

The question which we are required to answer

here is whether under the law of Arizona decedent's wife had a community property interest to be excluded from the computation of his estate. We are, of course, controlled herein by state law. *Black v. Commissioner*, 114 Fed. (2d) 355. See also *Talcott v. United States*, 23 Fed. (2d) 897.

The property involved is personalty, consisting of stocks and bonds, largely corporate stock of the Carborundum Co.; also cash. A portion of the property, the amount not shown except that it was "sizeable", was inherited by the husband, and inherited property is by the Arizona statute specifically excepted from community estate, so that with such a record we could not determine that any of the property was originally community. The evidence clearly indicates that the husband separately acquired the property prior to removal to Arizona. The petitioner pointedly disclaims any contention that the property was originally acquired as community property. We therefore hold that the property was originally the separate property of the decedent. The petitioner states the question as follows: "The primary question presented is that of transmutation by understanding and intention." We therefore examine the record to ascertain whether under all of the evidence it is shown that property originally separately owned by the decedent became that of a marital community in Arizona. The petitioner relies in substance upon the idea that there was a general understanding between the husband and wife that their property

was held as community estate, and upon statements which the husband made to the effect that half belonged to her and that the property was community. There was no written communication, understanding or document on the subject. The husband made such statements on two occasions to a friend and upon one occasion, in the presence of such [19] friend and in the course of a family argument, the wife said to her husband, "You know, Charles, that one-half of all we own belongs to me", to which the husband stated, "That is correct, and I know it as well as you do." This is the only occasion shown by the evidence where any agreement between husband and wife expressly appears. It is obvious, of course, that the oral statements above recited do not amount to a conveyance. The petitioner, however, urges that under the law of California such statements suffice to transmute separate property into community estate and urges us to follow such decisions. Under the law of California an executed oral agreement is sufficient transmutation of separate property into community. *Schipper v. Penkalski*, 115 Pac. (2d) 231; *Yoakam v. Kingery*, 126 Calif. 30, 58 Pac. 324; *Estate of J. Harold Dollar*, 41 B. T. A. 869; *United States v. Goodyear*, 99 Fed. (2d) 523. *Title Insurance & Trust Co. v. Ingersoll*, 94 Pac. 94; and *Kaltschmidt v. Weber*, 79 Pac. 272, indicate that in California express argument need not be shown if it is proven by the nature of the transaction or surrounding circumstances. *Estate of Joe Crail*, 46 B. T. A.—(Mar. 17, 1942).

We have for consideration here, however, not only the oral expressions above noted, but also documents in writing, signed by both husband and wife. In 1928, the year following that in which the decedent moved to Arizona, and several years before the family argument and statement above referred to, petitioner and his wife signed a contract of rental of safety deposit box from the Southern Arizona Bank & Trust Co. Therein, over their signatures, it is stated that they declare and represent that they own as joint tenants with the right of survivorship all of the property within or which may be deposited in the box, and that it shall be and is owned by them as such joint tenants. They jointly and severally authorized the bank to grant access to either of them, and jointly and severally obligated themselves to save the bank harmless. Further reference is made to the survivor. It is recited that the signers have read, received a copy of, and approved the bank's rules covering safe deposit boxes as printed on the reverse side. On the reverse side reference is made to the survivor.

On or about January 5, 1928, a checking account was opened in the same bank in the name of "Greenwood, C. H., or Albertine, Either, or Survivor of Either", that expression appearing on the signature cards which bear the signatures of C. H. Greenwood and Albertine Greenwood. In 1934 a savings account was opened in the same bank by "Greenwood, C. H. or Albertine", that expression appearing upon the signature card bearing the sig-

natures of C. H. Greenwood and Albertine Greenwood. [20]

All of the personalty and assets involved in this case, consisting of stocks, bonds, certificates, and documents of title, was, at the date of the death of the decedent, in the safe deposit box above described. Of the cash, \$3,553.52 was in the joint checking account in the Tucson bank, \$4,320.01 in the savings account therein, and \$18,834.74 represents savings accounts in decedent's name in other banks. It is apparent that, if the decedent and his wife were at the date of his death the owners in joint tenancy of the property deposited in the safe deposit box and in the joint checking account, such property must be included in the gross estate of the decedent, under the provisions of section 302 (e), Revenue Act of 1926.¹ Moreover, the language

¹Sec. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

* * * * *

(e) To the extent of the interest therein held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: Provided, That where such property or any part thereof, or part of the consideration with which such property was acquired, is

of the act seems specifically to cover the deposits both in safe deposit box and checking account. The petitioner argues that the doctrine of survivorship is not favored by the law in Arizona, and that it is a matter of intention on the part of the parties, *In re Baldwin's Estate*, 71 Pac. (2d) 791, and suggests that the right of survivorship in that state may have been abolished. However, upon examination of the Arizona statute and construction thereof by the Supreme Court of Arizona, we find that if the instrument expressly vests estate in the survivor, the right of survivorship exists, although proof of a contrary intention on the part of the parties would suffice to destroy the joint ownership. *In re Baldwin's Estate*, *supra*; *Blackman v. Blackman*, 43 Pac. (2d) 1011. Examination of the contract signed and entered into by the decedent and

shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: Provided further, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants.

his wife in renting the safe deposit box containing the larger portion of his estate indicates clearly to us that the instrument does “expressly vest the estate in the survivor” under the Arizona statute, section 986, Revised Code Arizona 1928, and negatives any idea of a contrary intent on the part of the signers. The provisions of such written agreement were [21] never revoked nor modified throughout more than ten years prior to the death of the decedent.

Agreements as to safe deposit boxes essentially the same as that above described have been held to preclude claims of community property by the California courts. In *re Harris’ Estate*, 147 Pac. 967, involved a claim of community property. The husband and wife had orally agreed that property should be owned as joint tenants and their moneys were deposited in a bank in a joint account with a written agreement in the pass book reciting joint tenancy and survivorship. It was held that there was joint tenancy. The same court In *re Gurnsey’s Estate*, 170 Pac. 402, considered a bank deposit in form to be paid to either husband or wife or the survivor, additions to become the property of the persons making the deposit as joint tenants, and concluded that community property deposited in such account passed out of the community at the time of the deposit and became the joint property of the husband and wife. In *In re McCoin’s Estate*, 50 Pac. (2d) 114, it was held that a husband and

wife having community ownership of money converted same into joint ownership by the terms of a signed signature card similar to that hereinabove described. The card bore the recitation that the undersigned gave each other a joint ownership in moneys deposited or thereafter to be deposited, payable to either or the survivor. *Young v. Young*, 14 Pac. (2d) 580, involved a question of community property or joint estate in connection with the renting of a safe deposit box by a husband and wife, as herein, and which safety deposit box contained the personal property in question—stocks and bonds. An agreement in writing between husband and wife in renting the safety deposit box recited a declaration that the contents then or thereafter should be joint property with ownership in the survivor. In addition, somewhat similar to the situation herein, the husband and wife opened a “deposit account” in another bank with an agreement signed to the effect that moneys deposited should be paid by the bank to either or the survivor. The court held that the property was joint and not community estate, although the personal property involved was placed in the safe deposit box by the husband, whose executor contended that it was community as against the wife’s claim by right of survivorship.

The above decisions clearly indicate, we think, not only the weight which should be given to the agreement of joint ownership as to the safe deposit

box and the joint bank account, but refute the petitioner's contention that joint tenancy can not be created by one person conveying to himself and another as joint tenants. In that respect see also *Colson v. Baker*, 87 N. Y. Supp. 238; *In re Gaines' Estates*, 100 Pac. (2d) 1055; *In re Nelson's Estate*, 286 Pac. 439. In [22] the light of such decisions we conclude that the evidence of oral understanding or agreement between the husband and wife here involved is not sufficient to indicate a change from the joint estate set up in writing in the safe deposit agreement and in the agreement as to the checking account. Indeed, it seems to us that in the light of such written agreement the oral statements later are explained and that they refer to the joint tenancy set up in writing. The oral references to community property and to ownership as half in each of the spouses may well have referred, in the minds of the decedent and wife, as laymen, to the joint estate in the property in bank. At least we think such references do not negative the written agreements or show an executed oral agreement sufficient under primary rules of law to overcome a previous written contract. We therefore hold that all property in the safe deposit box and in the checking account payable to either or the survivor was not community property, but joint estate, to be included in the estate of decedent. The record indicates plainly that the property did not originally belong to the survivor within the excep-

tion recited in section 302 (e) of the Revenue Act of 1926.

As to the remainder of the decedent's estate not appearing to have been covered by the written agreements as to joint ownership: We conclude that the evidence is not sufficient to indicate community property. Assuming that an oral understanding is sufficient to transmute separate estate into community property, under the law of the state in question, we note that the evidence as to oral agreement placed all property in the same category—the contention being that all was community and that everything was owned in like manner by the husband and wife. Having concluded that almost the entire estate was held in joint tenancy, we believe this indicates that the remainder was so held; or, if not, that the effect of the written evidence as to joint tenancy is such as to indicate that the separate estate of the husband in the other bank accounts is not shown to have been transmuted into community estate. The evidence is that all of his assets, including documents of title and certificates, were in the safe deposit box—which we above concluded contained property held by joint tenancy. The box, therefore, apparently contained the certificates of deposit by the husband in the other separate bank deposits in Massachusetts; Phoenix, Arizona; and Los Angeles, California, for they obviously are covered by the expression “assets, securities and other documents of title” and “certificates” used to describe the contents of the safe deposit

box. Certainly that they were not in such box is not shown by the record. The oral understanding relied upon by the petitioner can not, we think, overcome the presumption of correctness of the Commissioner's determination as to any property, in the [23] light of our conclusion as to the written agreements covering the joint bank accounts and deposits, for no distinction is made in the evidence as to oral agreement sufficient to separate one bank account from the other. Moreover, we find that section 265, Revised Code Arizona 1928, particularly provides that:

Whenever a husband and wife open a joint account with any bank, and either one dies, such bank shall pay to the survivor the amount standing to their joint credit and upon making such payment such bank shall be released from all further liability for such amount.

This section places the savings account in the Tucson bank in the same category as the other accounts where "survivor" is used. Since all bank accounts shown to enter into the computation of the estate, except those which we have above concluded represent joint estate, are in the name of the decedent, and certificates therefor were apparently in the joint safe deposit box, we conclude and hold that no sufficient showing of community estate therein has been made, and that error on the part of the respondent is not shown.

Decision will be entered under Rule 50. [24]

United States Board of Tax Appeals
Washington

Docket No. 104987.

ESTATE OF CHARLES H. GREENWOOD, De-
ceased, KENNETH R. GREENWOOD, Ad-
ministrator,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Findings of Fact and Opinion of the Board promulgated April 3, 1942, the respondent on April 21, 1942, filed recomputation under Rule 50. Copy of said recomputation having been served on the petitioner, together with notice of hearing, and the proceeding having been called for settlement from the Day Calendar of May 20, 1942, at which time no objection was offered to the proposed recomputation, it is

Ordered and Decided: That there is a deficiency in estate tax in the amount of \$18,491.76.

Enter:

Entered May 29, 1942.

(Signed) R. L. DISNEY

[Seal]

Member. [25]

[Title of Board and Cause.]

PETITION FOR REVIEW BY THE UNITED
STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

To the Honorable, the Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

Comes now Kenneth R. Greenwood, as administrator of the estate of Charles H. Greenwood, deceased, and by his attorney, John M. Schwartz, respectfully petitions this Honorable Court to review the decision of the United States Board of Tax Appeals entered on May 29, 1942, and finding a deficiency in estate tax due from said estate in the amount of \$18,491.76, and herein petitioner respectfully shows that:

I.

NATURE OF CONTROVERSY

The decedent, Charles H. Greenwood, and Albertine Greenwood were married in 1899, and they resided during the greater part of their married life in the State of New York. [26] In the year of 1927 they moved to the State of Arizona and from that time to the date of the death of the said Charles H. Greenwood they were bona fide residents of that State. Mr. Greenwood died testate on the 21st day of July, 1939, and thereafter Kenneth R. Greenwood was duly appointed administrator with will annexed of his estate. While it could not be ascertained from the decedent's records what portion of

the estate was acquired after he became a resident of Arizona, it is conceded that the greater part thereof, perhaps the nucleus of all, was acquired before that time.

Within the time prescribed by law the said administrator filed a federal estate tax return on which he listed all property held by the decedent at the time of his death and showed one-half of the value thereof as taxable on the theory that the property was the community property of the decedent and Mrs. Greenwood at the time of the decedent's death. The tax computed and paid by the administrator was \$5,061.57. Thereafter the Commissioner of Internal Revenue caused an examination to be made of said return, and upon examination determined a tax liability of \$23,562.85 and thereupon assessed a deficiency of \$18,501.28.

Thereafter said administrator petitioned the United States Board of Tax Appeals for a re-determination of the tax liability of the estate, and the said Board upon hearing, rendered its decision and ordered and decided that a deficiency of \$18,491.76 existed.

The administrator, as petitioner before the Board, contended that all property held by decedent at the time of his death, except an interest in a trust fund not here in controversy, was community property. This contention was based upon the proposition that by virtue of mutual understanding and intention between Charles H. Greenwood and Albertine Greenwood, as husband and wife, and their acts in accord-

ance therewith, the property brought by them to the State of Arizona in 1927, and all income and increment thereof, became community property. The Commissioner of Internal Revenue as respondent before the Board contended that all property held in the name of the decedent at the time of his death was his sole and separate property. This contention was based upon the proposition that all property brought by the parties to the State of Arizona in 1927 was the sole and separate property of the husband by virtue of the law of the state in which it was acquired and that it remained the sole and separate property of the husband regardless of the alleged mutual understanding and intention and acts of the parties.

In due course after hearing the Board promulgated its findings of fact and opinion, concluding that the property in question was held by husband and wife at the time of decedent's death as joint property with right of survivorship, and therefore taxable in its entirety as the estate of the husband. [28]

Petitioner now contends that the facts found by the Board show that the property involved became community property under the law of Arizona, and that the conclusion of the Board is erroneous.

It is from the decision based upon that conclusion by the Board that the Petitioner herein seeks review.

II.

COURT IN WHICH REVIEW IS SOUGHT

Petitioner herein seeks review in the United

States Circuit Court of Appeals for the Ninth Circuit.

III.

FACTS SHOWING VENUE

At the time of his death the said Charles H. Greenwood was a resident of Tucson, Arizona.

The Federal estate tax return filed by the said administrator for the estate of the said Charles H. Greenwood, deceased, was filed with the Collector of Internal Revenue for the District of Arizona, at Phoenix, Arizona.

Hearing before the United States Board of Tax Appeals was had at Los Angeles, California, on the 23rd of September, 1941, Honorable R. L. Disney, presiding.

The decision of the United States Board of Tax Appeals was signed by R. L. Disney, member, and entered on the 29th day of May, 1942, in which it was ordered and decided that there is a deficiency in the estate taxes of \$18,491.76. [29]

The jurisdiction in this Court to review the aforesaid decision of the United States Board of Tax Appeals is founded on Section 1141 of the Internal Revenue Code.

Wherefore your petitioner prays that this Honorable Court review the said decision and order of the United States Board of Tax Appeals and direct the said Board to make and enter a decision ordering and deciding that the property in controversy

was the community property of decedent and his wife at the time of his death, and petitioner further prays for the entry of said further orders and decisions as shall by this Court be deemed just and proper, in accordance with law.

JOHN M. SCHWARTZ

215 West Seventh Street,

Los Angeles, California,

Attorney for Petitioner.

[Endorsed]: U.S.B.T.A. Filed June 29, 1942. [30]

[Title of Board and Cause.]

NOTICE OF FILING PETITION FOR
REVIEW

To the Commissioner of Internal Revenue, Washington, D. C., and J. P. Wenchel, chief counsel, Bureau of Internal Revenue, Washington, D.C.:

You are hereby notified that on the 29th day of June, 1942, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause was filed with the Clerk of the Board, a copy of which petition is attached hereto and served upon you.

Dated 7th day of July, 1942.

JOHN M. SCHWARTZ,

Attorney for Petitioner,

215 West 7th St.,

Los Angeles, Calif.

Service of the foregoing Notice of Filing and a copy of petition for the review is hereby acknowledged.

Dated 13th day of July, 1942.

J. P. WENCHEL

[Endorsed]: U.S.B.T.A. Filed July 13, 1942. [31]

[Title of Board and Cause.]

PETITIONER'S STATEMENT OF POINTS
AND DESIGNATION OF RECORD ON RE-
VIEW

STATEMENT OF POINTS

The petitioner hereby sets forth the points on which he intends to rely on review, as follows:

I.

Upon the death of either husband or wife only one-half of the community property in which the parties had equal interests is subject to federal estate tax.

II.

The nature of property and the respective interests of husband and wife therein are determined by the law of the state in which the husband and wife reside, and upon the death of either that law controls in ascertaining the taxable estate of the decedent. [32]

III.

Under the law of the state of Arizona, the interests of husband and wife in community property are in all respects equal, the husband having no title superior to that of the wife.

IV.

Under the law of the state of Arizona, where either husband or wife has separate property and it is their intention to treat such property as the community property of both it becomes community property in accordance with their intent; and insofar as personal property is concerned it is not necessary that such transmutation be expressed formally, either verbally or in writing, as long as it can be fairly inferred from the circumstances that a community interest was intended.

V.

Joint tenancy is not a favorite of the law of Arizona, and where property is held by a husband and wife by an instrument expressly describing them as joint tenants with right of survivorship such property will be deemed to be community property if the parties so intend.

VI.

Under the law of the state of Arizona, where two or more persons hold property as joint tenants, and the [33] grant or devise does not expressly vest title in the survivor, the interest of a joint owner passes

to his heirs and beneficiaries upon his death as though severed prior thereto.

VII.

Under the law of the state of Arizona, a joint tenancy with right of survivorship can in no case be created by a transfer from one owner to himself and another as joint tenants with right of survivorship.

VIII.

In the instant cause the Board of Tax Appeals concluded upon its findings of fact that the property involved was joint tenancy property at the time of the decedent's death; and because such property was acquired by the decedent and his wife while they resided in a non-community property state the Board further concluded that all was subject to the federal estate tax. The petitioner, relying upon the foregoing points and the Board's findings of fact, contends that the property was community property and only one-half thereof subject to tax. [34]

DESIGNATION OF RECORD ON REVIEW

The petitioner hereby designates the parts of the record which he thinks necessary for consideration of the points on which he relies, as follows:

1. Petitioner's petition.
2. Respondent's answer.
3. Minute entries.
4. Board's findings of fact and opinion.
5. Board's decision.
6. Petitioner's petition for review.

7. Notice of filing petition for review.

8. Petitioners' statement of points and designation of record on review.

Dated at Los Angeles, California, the 15th day of July, 1942.

JOHN M. SCHWARTZ

215 West Seventh Street,

Los Angeles, California,

Attorney for Petitioner.

A conformed copy of the foregoing Statement of Points and Designation of Record on Review was duly received by the respondent on the date shown below.

Dated July 17, 1942.

J. P. WENCHEL

Atty. for Respondent.

[Endorsed]: U.S.B.T.A. Filed July 30, 1942. [35]

[Title of Board and Cause.]

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 35, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand

and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 31st day of July, 1942.

[Seal]

B. D. GAMBLE

Clerk,

United States Board of Tax Appeals.

[Endorsed]: No. 10217. United States Circuit Court of Appeals for the Ninth Circuit. Kenneth R. Greenwood, Administrator of the Estate of Charles H. Greenwood, Deceased, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed August 10, 1942.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
For the Ninth Circuit
No. 10217

ESTATE OF CHARLES H. GREENWOOD, De-
ceased, KENNETH R. GREENWOOD, Ad-
ministrator,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S STATEMENT OF POINTS
AND DESIGNATION OF RECORD ON RE-
VIEW

To the Clerk of the United States Circuit Court of
Appeals for the Ninth Circuit:

Comes now the petitioner and adopts as his points
on appeal the statement of points appearing in the
transcript of record, and he hereby requests that
the transcript of record as certified to you be
printed in its entirety.

Dated at Los Angeles, California, this 13th day of
August, 1942.

JOHN M. SCHWARTZ
215 West Seventh Street,
Los Angeles, California,
Attorney for the petitioner.

[Endorsed]: Filed Aug. 15, 1942.

No. 10217.

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

KENNETH R. GREENWOOD, Administrator of the Estate of
Charles H. Greenwood, Deceased,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

JOHN M. SCHWARTZ,
215 West 7th Street, Los Angeles, California,
Attorney for Petitioner.

FILED

OCT 27 1942

PAUL P. O'BRIEN,
CLERK

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No. 10217.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

KENNETH R. GREENWOOD, Administrator of the Estate of
Charles H. Greenwood, Deceased,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

The above entitled case has come before this Court on a petition for review of a decision of the United States Board of Tax Appeals [R. pp. 35 to 39] wherein the Board, by decision entered May 29, 1942, ordered and decided that a deficiency in estate tax in the amount of \$18,491.76 existed against the above named petitioner [R. p. 34].

The petitioner filed the estate tax return involved in this case with the Collector of Internal Revenue for the District of Arizona [R. p. 16]. Thereafter, in July, 1940, the respondent delivered to the petitioner a notice of deficiency [R. pp. 8 to 13 and 16] from which the petitioner appealed by petition filed with the United States Board of

Tax Appeals on the 27th day of September, 1940 [Docket Entries, R. p. 1; pp. 3 to 13]. A copy of the petition was duly served on the respondent [Docket Entries, R. p. 1] and he thereafter regularly filed and served his answer [Docket Entries, R. p. 1; pp. 13 to 15]. A hearing on the merits was had before the Board sitting at Los Angeles, California, on the 23rd day of September, 1941 [Docket Entries, R. p. 2], and in regular order the Board, on April 3, 1942, promulgated its findings of fact and opinion [R. pp. 16 to 33] and in due course made and entered the decision in respect of which the review herein is sought.

Jurisdiction of the United States Board of Tax Appeals to review the deficiency found by the respondent is expressly conferred by Section 1101 of the Internal Revenue Code, which reads as follows:

“The Board and its divisions shall have such jurisdiction as is conferred on them by chapters 1, 2, 3, and 4 of this title, by Title II and Title III of the Revenue Act of 1926, 44 Stat. 9, or by laws enacted subsequent to February 26, 1926.”

And jurisdiction of this Court to review a decision of the Board is expressly conferred by Section 1141 of the Internal Revenue Code, which reads as follows:

“(a) JURISDICTION.—The Circuit Courts of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board, except as provided in section 239 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, Sec. 346); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, Sec. 347).

“(b) VENUE.—

“(1) IN GENERAL.—Except as provided in paragraph 2, such decisions may be reviewed by the Circuit Court of Appeals for the circuit in which is located the collector’s office to which was made the return of the tax in respect of which the liability arises or, if no return was made, then by the United States Court of Appeals for the District of Columbia.”

Statement of the Case and Questions Involved.

The issue presented in the instant case is whether all of the property in which the decedent, Charles H. Greenwood, had an interest at the time of death may properly be taxed in its entirety as property of his estate, or whether his wife had such a vested interest therein that only one-half of its value may be properly taken as the measure for purpose of federal estate tax.

The decedent and his wife, Albertine Greenwood, were married in 1899 and resided during the greater part of their married life in the State of New York [R. p. 16]. In the early part of 1927 they established residence in Tucson, Arizona, where they lived continuously until Mr. Greenwood’s death on July 21, 1939 [R. pp. 16 and 17].

At the time of marriage neither the decedent nor his wife had any property, and aside from about \$1,000.00 inherited by the wife in 1937 and an inheritance received from the decedent’s mother in 1927, the amount of which was not ascertained herein, the estate in which the decedent had an interest at the time of death was acquired by his earnings [R. pp. 17 and 20]. Neither engaged in remunerative occupation nor employment after moving to Arizona.

None of the property of the parties was community property at the time they became residents of Arizona, but shortly thereafter, in 1928, they rented a safe deposit box under a rental agreement wherein they declared equal ownership as joint tenants [R. pp. 18 and 19] and they thereafter kept all their securities and documents of title therein [R. p. 19] and treated the estate involved herein as property belonging to them equally, and in their discussions of their property relations it was always referred to as community property [R. pp. 21 to 23]. Their two bank accounts in Tucson, Arizona, were kept in both names [R. pp. 19 and 20] and all real estate owned by them was held in the name of both [R. p. 22]. (The real estate, however, is not involved in the instant case.) All other property was carried in the name of the decedent [R. p. 22]. It was their understanding and intention to hold the estate as community property and it was mutually understood that the survivor should take all by virtue of the will of the other, and their wills so provided [R. p. 23].

All property involved in the instant case is personalty, consisting principally of securities and cash [R. p. 24].

In filing the estate tax return the petitioner herein reported the estate as community property and computed a tax upon one-half of the total net value thereof. The respondent thereafter determined a deficiency of \$18,501.28 [R. p. 16] on the ground that the entire estate was the separate property of the decedent at the time of his death [R. p. 23].

The petitioner contends that the estate became community property by virtue of the facts found by the Board and the law of the State of Arizona, while the respondent has contended that the estate remained the sole and separate property of the decedent. The Board has concluded that all of the estate involved became joint tenancy prop-

erty because of the safe deposit box rental agreement and the application of state law [R. pp. 23 to 33].

It being conceded at the outset that substantially all of the estate was acquired by the parties while they resided in the State of New York, and by virtue of the law of that state was originally the property of the decedent, the questions now presented are as follows:

1. Under the law of the State of Arizona, may a husband and wife, residing therein, transmute the separate personal property of the husband to the community property of both by mutual understanding and intention to do so?

And, if so, does such transmutation take effect when husband and wife bring separate personal property of the husband to Arizona and agree between themselves that half of it is the wife's, and always refer to it as community property, and in all respects treat it as such?

2. Under the law of the State of Arizona, where a husband and wife rent a safe deposit box from a banking institution and by writing on the signature card pertaining thereto declare and represent that they own as joint tenants, with right of survivorship, all the property of every kind then within said box or to be placed therein, and at all times thereafter refer to such property as community property equally owned by both, and make wills bequeathing their respective interests, and otherwise handle the property as community property, do stocks, bonds and other documents of title written in the name of the husband alone, deposited in said box, become the joint tenancy property of both and upon his death pass to her by right of survivorship?

Assignments of Error.

I.

The Board of Tax Appeals erred in concluding that the property involved was held by the decedent and his wife as joint tenants, because its findings of fact do not support its opinion and decision promulgated and entered, in that the findings show that the stocks, bonds and other documents of title were held in the name of the decedent [R. p. 22]; that he and his wife each recognized equal interests [R. pp. 18, 19, 22 and 23]; that they always referred to the property as community property [R. pp. 21 and 23]; that they made wills devising and bequeathing their respective interests [R. p. 23]; that the grants do not vest title in the survivor, and the transfers were made directly from the husband to himself and wife.

II.

The Board of Tax Appeals erred in its opinion and decision in that it did not conclude upon its findings of fact that the property involved was community property, because the findings show that the decedent and his wife understood that they owned equal interests therein [R. pp. 18, 19, 22 and 23], and they always referred to the property as community property [R. pp. 21 and 23] and so treated it for all purposes.

ARGUMENT.

POINT I.

Upon the Death of Either Husband or Wife Only One-half of the Community Property in Which the Parties Had Equal Interests Is Subject to Federal Estate Tax.

POINT II.

The Nature of Property and the Respective Interests of Husband and Wife Therein Are Determined by the Law of the State in Which the Husband and Wife Reside, and Upon the Death of Either, That Law Controls in Ascertaining the Taxable Estate of the Decedent.

It is believed that no controversy is presented in the instant case by the two foregoing propositions of law as it appears that the Board of Tax Appeals proceeded upon those points in rendering its opinion and decision, citing *Black v. Commissioner*, 114 Fed. (2d) 355, and *Talcott v. United States*, 23 Fed. (2d) 897 [R. p. 24].

POINT III.

Under the Law of the State of Arizona, the Interests of Husband and Wife in Community Property Are in All Respects Equal, the Husband Having No Title Superior to That of the Wife.

In the instant case the decedent was a resident of the State of Arizona at the time of his death, so we are here governed by the laws of that state in determining the property interests of himself and wife. Under the community

property system there obtaining, the equal interests of husband and wife have long been recognized. On that point the Supreme Court of Arizona has said:

“The law makes no distinction between the husband and wife in respect to the right each has in the community property. It gives the husband no higher or better title than it gives the wife. It recognizes a marital community wherein both are equal. Its policy plainly expressed is to give the wife in this marital community an equal dignity, and make her an equal factor in the matrimonial gains. * * *

“The law, in giving this power to the husband during coverture to dispose of the personal property, does not do this in recognition of any higher or superior right that he has therein, but because the law considers it expedient and necessary in business transactions affecting the personalty to have an agent of the community with power to act.”

La Tourette v. La Tourette, 15 Ariz. 205, 206, 137 Pac. 426, at 428.

As in the case of Points I and II, it is apparent that the Board has not questioned this proposition of law in its opinion and decision, but we present these propositions as a step toward the real issue.

POINT IV.

Under the Law of the State of Arizona, Where Either Husband or Wife Has Separate Property and It Is Their Intention to Treat Such Property as the Community Property of Both it Becomes Community Property in Accordance With Their Intent; and in so far as Personal Property Is Concerned it Is Not Necessary That Such Transmutation be Expressed Formally, Either Verbally or in Writing, as Long as it Can be Fairly Inferred From the Circumstances That a Community Interest Was Intended.

It seems well established that, contrary to the doctrine of the common law, husband and wife residing in the State of Arizona may contract with each other concerning the interest of either in property. (*Luhrs v. Hancock*, 6 Ariz. 340, 57 Pac. 605; *Estate of Baldwin*, 50 Ariz. 265, 71 Pac. (2d) 791.) Clothed with this power it follows that they may change the community property of both to the separate of either, and the separate property of one to the community property of both. Upon these points it appears that the courts of Arizona, Washington and California are in accord, and the law of Washington and California may be taken as the law of Arizona upon the points we are here discussing, a fact of importance in view of the small volume of litigation of that nature brought before the Supreme Court of Arizona.

Citing with approval the case of *Volz v. Zang*, 113 Wash. 378, 194 Pac. 409, the Supreme Court of Arizona has said:

“When spouses have treated the income from their separate property as community, and it was their intent that it should become community, the character

of the income changes in accordance with their intention.”

Rundle v. Winters, 38 Ariz. 239, at 245, 298 Pac. 929, at 931.

And in the case of *Volz v. Zang*, *supra*, the Supreme Court of Washington pointed out that the laws of that state gave to husband and wife a right to deal in every possible manner with their property, and relying upon California authorities it said:

“* * * In *Yoakam v. Kingery*, 126 Cal. 30, 58 Pac. 324; *In re McCauley's Estate*, 138 Cal. 432, 71 Pac. 458, and *Title Ins. & Trust Co. v. Ingersoll*, 153 Cal. 1, 94 Pac. 94, the Supreme Court of California has held that a deed from husband or wife was sufficient ‘to transmute the separate estate of either of them into community property, if it was properly executed.’ * * *”

“Our statutes are not identical with those of California; but under our statutes, the right of husband and wife are no more restricted than those enjoyed under the California statutes. * * *” (Certain statutes cited.)

“It would seem from these statutes that the husband and wife have been given a right to deal in every possible manner with their property. Broad, general powers are given which must include the lesser and more restricted powers. Moreover, this court has already indicated that the husband or wife may change the status of separate property to community property * * *”

Volz v. Zang, 113 Wash. 378, at 380 and 381, 194 Pac. 409, 410.

The respondent has heretofore recognized the rule that husband and wife residing in Washington may transmute separate personal property to community property by verbal agreement (G. C. M. 19248, XVI-46-9036; Vol. 3, 1937 C. C. H., 8344), and the above quoted statement from the case of *Rundle v. Winters* can leave no doubt that husband and wife can change separate personalty to community by mere intention to do so. Many cases in point have come before the courts of last resort in California and the rule hereinbefore stated has been invariably affirmed. Thus it has been said:

“The fact that each of them had at their marriage a few hundred dollars as separate property is not controlling as by mere verbal agreement these sums could have been transmuted into community property.”

Estate of Kelpsch, 203 Cal. 613, at 616, 265 Pac. 214, at 215.

and,

“In the present case there was a meeting of the minds and any form of expressed words, either spoken or written, that the property was to be considered community property was sufficient.”

Estate of Wahlfeld, 105 Cal. App. 770, at 776, 288 Pac. 870.

and again,

“It clearly appears from the foregoing authorities that the agreement or understanding between the parties is not required to be in any particular words and need not be attended with any particular formality as long as it may be fairly inferred from all of

the circumstances in evidence that a community interest was intended by the parties.”

Estate of Sill, 121 Cal. App. 202, at 204, 9 Pac. (2d) 243, at 244.

In the case of *Estate of Kelpsch, supra*, there was involved the title to certain property brought by husband and wife, about five years before her death, from the state of Illinois, a common law state, to the state of California, a community property state. It appears that after becoming residents of California they retained certain investments in their joint names, and made others, and kept their bank accounts in the name of the wife alone. It further appears that she took control of their business affairs because of her better ability to handle such matters, and that she often spoke of their relation as a partnership. The Supreme Court affirmed the order of the trial court holding all property to be community.

In the case of *Estate of Sill, supra*, it was contended by the appellant that certain real estate held in the name of the decedent was decedent's separate property. He had paid the greater part of the purchase price and had taken title in his name alone and immediately thereafter assured his wife that “It is just as much yours as it is mine; this is our home.” In affirming the judgment of the trial court, the District Court of Appeal said (page 205):

“While the parties did not formally agree in precise words that the property should be community property, it is a fair inference from all the circumstances that such was their intention and understanding.”

In the case here presented it is apparent that the decision of the Board is based upon its conclusion that the

property involved was changed from the separate property of the husband to the joint tenancy property of himself and wife by virtue of the safe deposit box rental agreement set forth in its findings of fact [R. pp. 18 and 19], but just what its conclusion and decision would have been in the absence of that document is not clear. Leaving that rental agreement for later discussion, it is submitted that the pertinent facts set forth in the findings afford no avenue of escape from the conclusion that a community property interest was understood, intended and effected. It is herein shown that the decedent and his wife understood that each had an equal interest [R. pp. 22 and 23], and that they considered the property to be community [R. pp. 21 to 23]. The fact that the securities were held in the name of the decedent alone is of no material importance, for such is the practice in all community property states, the husband alone having power to dispose of community personalty. To join the wife in title would only impair the facility of negotiation. In the case of real estate, however, the wife must join in conveyance, so it is worthy of note that the real estate owned by the decedent and his wife was held in both names [R. p. 22], and that the respondent has not contended that it was not community property. The facts that the decedent turned over to his wife a monthly allowance for household expenses [R. p. 20]; that he received the income and handled it without control by the wife [R. p. 21]; that he gave her no accounting [R. p. 21]; and that he prepared both income tax returns [R. p. 22] are all consistent with the community property theory and contrary to a joint tenancy theory concluded by the Board. And the facts that both husband and wife considered her interest equal to his [R. pp. 22 and 23]; that they spoke of the

property as community property [R. pp. 21 to 23]; that they kept both active bank accounts in both names [R. p. 20]; that she joined in renting the safe deposit box and kept a key thereto [R. pp. 19 and 21]; and that they had like wills each naming the other as beneficiary [R. p. 23] are entirely inconsistent with the separate property theory contended by the respondent.

It is submitted, therefore, that if this Court is of the opinion that a joint tenancy was not created by the decedent and his wife, it should conclude that the property involved became community property under Arizona law.

We now pass to a discussion of the joint tenancy issue.

POINT V.

Joint Tenancy Is Not a Favorite of the Law of Arizona, and Where Property Is Held by a Husband and Wife by an Instrument Expressly Describing Them as Joint Tenants With Right of Survivorship Such Property Will be Deemed to be Community Property if the Parties so Intend.

Joint tenancy with its attendant right of survivorship has never been a favorite of the law of Arizona and statutes abolishing it in most cases have long been in force. Section 1102, Revised Statutes of 1913, read as follows:

“Where two or more persons hold an estate, real, personal or mixed, jointly, and one joint owner dies before severance, his interest in said joint estate shall not survive to the remaining joint owners, but shall descend to and be vested in the heirs and legal representatives of such deceased joint owner, in the same manner as if his interest had been severed and ascertained.”

However, sections 4708 and 4709 of the same Revised Statutes authorized creation of joint tenancies in real property, notwithstanding the inclusion of that class of property within the scope of section 1102. Sections 4708 and 4709 became section 2777 of the Revised Code of Arizona, 1928, and the aforesaid section 1102 became section 986 of the 1928 Code. The language of section 986 remains unchanged, and is as follows:

“Right of survivorship abolished. Where two or more persons hold property jointly and one joint owner dies before severance, and the grant or devise does not expressly vest the estate in the survivor, the interest in the estate of the owner dying shall not survive to the remaining joint owners but shall descend to the heirs of the deceased joint owner as though his interest had been severed and ascertained.”

It is often stated that it was the object of the legislation in preparing the Revised Code of 1928 to change the legal meaning of the existing law as little as possible, and considering the rule of construction stated by the Supreme Court of Arizona in the case of *Estate of Sullivan*, 38 Ariz. 387, 300 Pac. 193, and the words “grant or devise” of the statute, ordinarily used in connection with real property, it would seem doubtful if personal property may in any case be the subject of joint tenancy.

In any case, however, it is clear that even where husband and wife are designated as joint tenants with right of survivorship the property is deemed to be community if the grantees so intend. On that point the Supreme Court of Arizona has said:

“It should not be overlooked on the one hand that the doctrine of survivorship is not a favorite of the

law, in fact, has been abolished in this state in most instances, section 986, *supra*, and upon the other, that the community property principle is too deeply rooted in the policy of this state to permit it to be set aside except in those cases in which the law clearly permits it and the parties so intend.”

Estate of Baldwin, 50 Ariz. 265, at 275, 71 Pac. (2d) 791, at 795.

In the instant case the findings of fact show that the parties intended to hold the property as community property and not as joint tenancy property [R. pp. 21, 22 and 23]. The decedent always referred to the property as being community [R. p. 21] and he and his wife each made a will devising and bequeathing their respective interests therein [R. p. 23], and they therefore did not intend to take by right of survivorship. The term community property has a well defined meaning even in the mind of laymen and it cannot be reasonably concluded that a man with the knowledge and business ability of the decedent in the instant case, a resident of the State of Arizona for many years, would refer to property as community property and make a will devising and bequeathing his interest therein when in fact he intended to hold the property as joint tenancy property which would vest in his wife upon his death without probate and irrespective of the provisions of the will.

The Board relies upon the *Baldwin* case, *supra*, to support its conclusion that a joint tenancy may be created between husband and wife [R. p. 28]. It is worthy of note, however, that in that case the property involved was real estate taken by the husband and wife by joint tenancy deed from a third person, while in the present case we are

concerned with personal property which came into the community directly from the husband, a point which will be later discussed herein. But even under the rule of that case, as shown above, the property will nevertheless be considered community if it is clearly the intention of the parties to do so. Speaking with reference to the question of joint tenancy with right of survivorship involved in the *Baldwin* case, wherein it was held that a joint tenancy in real estate could be created by the husband and wife if the grant expressly stated and they so intended, the Supreme Court of Arizona in the case of *Henderson v. Henderson*, 121 Pac. (2d) 437, said "Whether the holding in that case was correct is, the court now feels, rather doubtful." In other words, the Supreme Court of Arizona has said that it now feels that the *Baldwin* case is unsound in so far as it permits joint tenancy with right of survivorship between husband and wife in any case, and that it decides the *Henderson* case only upon the rule of *stare decisis* because of possible injustice that might otherwise be imposed upon innocent persons taking property under the authority of the *Baldwin* case.

In view of the foregoing pronouncements by the Supreme Court it would not seem logical to conclude that that court would, under facts similar to those in the present case, hold that a joint tenancy with right of survivorship was created. In other words, it would not seem reasonable to assume that the Supreme Court of Arizona would disregard the evidence showing that the decedent and his wife considered the property to be community property and contrary to its pronouncement of policy conclude that joint tenancy with right of survivorship existed.

POINT VI.

Under the Law of the State of Arizona, Where Two or More Persons Hold Property as Joint Tenants, and the Grant or Devise Does Not Expressly Vest Title in the Survivor, the Interest of a Joint Owner Passes to His Heirs and Beneficiaries Upon His Death as Though Severed Prior Thereto.

Section 986 of the Revised Code of Arizona, 1928, *supra*, clearly states that in no case may a joint tenancy with right of survivorship be created unless the grant specifically vests title in the survivor. With that section in mind, and putting aside other questions of law discussed and to be discussed, the question might be asked, What in the instant case is the grant? Is it the safe deposit box rental agreement, or are the stock certificates and other documents of title grants?

The Board seems to conclude that the safe deposit box rental agreement is the grant within the meaning of the statute. If that conclusion is correct, then it would naturally follow that the mere taking of a stock certificate from the box would change its title status, because it is clear that an oral joint tenancy cannot exist under Arizona law, and it is equally clear from the facts in the instant case that all of the certificates and other documents of title to personal property were in the name of the decedent alone [R. p. 22]. Such a conclusion seems unsound. It seems obvious, therefore, that the stock certificates and other documents were grants within the meaning of the statute, and not bearing the name of the decedent and his wife as joint tenants with right of survivorship they fall into the category of community property.

POINT VII.

Under the Law of the State of Arizona, a Joint Tenancy With Right of Survivorship Can in No Case Be Created by a Transfer From One Owner to Himself and Another as Joint Tenants With Right of Survivorship.

It seems to be the established rule of the common law that a joint tenancy cannot be created by one person conveying his own property to himself and another as joint tenants, because of lack of the essential unities. (*Corpus Juris*, Volume 33, Sec. 9, page 907.) That rule, which does not seem contrary to the rule stated in the *Baldwin* case wherein the unities were not in question, would appear to be the law of Arizona. Section 3043 of the Revised Code of Arizona, 1928, the code applicable in the instant case, reads as follows:

“*Common law adopted as far as applicable.* The common law, so far only as it is consistent with, and adapted to the natural and physical conditions of this state, and the necessities of the people thereof, and not repugnant to, or inconsistent with, the constitution of the United States, or the constitution or laws of this state, or established customs of the people of this state, is hereby adopted and shall be the rule of decision in all courts of this state. (Sec. 9, Ch. 10, L. '07; 5555, R. S. '13.)”

The cases cited by the Board to sustain a conclusion that the property involved herein was joint property with right of survivorship are all California cases except one and that one is a New York case [R. pp. 29 to 31]. It would seem that neither could be relied upon as authority in construing the law of Arizona. Joint tenancy has

always been favored by the law of California, and Section 683 of the Civil Code of that state was enacted many years ago and has been amended until it now specifically permits the creation of a joint tenancy by transfer from a sole owner to himself and others. So it can be readily seen that that policy is contrary to the policy obtaining in the jurisdiction of Arizona. The New York case of *Colson v. Baker*, cited by the Board [R. p. 31], is definitely a minority holding in the United States, as shown by the citations and discussion in 62 A. L. R. 514. It is clear that the majority holding in the United States is that the four unities must co-exist unless that rule is abrogated by statute. (*Deslauriers v. Senesac*, 331 Ill. 437, 163 N. E. 327; *Breitenback v. Schoen*, 183 Wis. 589, 198 N. W. 622; *Wright v. Knaff*, 183 Mich. 656, 150 N. W. 315.)

In the instant case there is no question that the decedent was the owner of substantially all the property involved, in one form or another, when he and his wife became residents of the State of Arizona, and he was never divested of title in any respect whatsoever prior to transmutation to himself and wife equally. It would therefore seem unreasonable to assume that the Supreme Court of the State of Arizona would turn back the rule of the common law, override its pronounced policy, disregard the presumption favoring community property, follow the rule of a minority and conclude that the property herein involved was held jointly with right of survivorship and not as community property.

Conclusion.

In conclusion, it is submitted that the points of law hereinbefore discussed and the findings of fact promulgated by the Board sustain the petitioner's assignments of error and support his contention that the property involved was community and not joint tenancy property. It is therefore respectfully asked that this Court reverse the decision of the Board and hold that all property involved was the community property of the decedent and his wife at the time of the death of the decedent, only one-half of which is subject to federal estate tax.

Respectfully submitted.

JOHN M. SCHWARTZ,

Attorney for Petitioner.

No. 10217

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

KENNETH R. GREENWOOD, ADMINISTRATOR OF THE ES-
TATE OF CHARLES H. GREENWOOD, DECEASED,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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FILED

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PAUL P. O'BRIEN

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals (R. 16-33) which is reported in 46 B. T. A. 832.

JURISDICTION

This petition for review (R. 35-39) involves federal estate tax for the year 1939. On July 27, 1940, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of \$16,823.49. (R. 8-13.) Within ninety days thereafter and on September 27, 1940, the taxpayer filed a petition with the

Board of Tax Appeals for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 3-13.) The decision of the Board of Tax Appeals sustaining the deficiency was entered May 29, 1942 (R. 34), and a deficiency determined (as corrected by stipulation) in the amount of \$18,501.28 (R. 16). The case is brought to this Court by a petition for review filed June 29, 1942 (R. 39), pursuant to provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the decedent and his wife transmuted his separate property into community property and therefore only one-half of its value is includible in his gross estate, or whether it remained his separate property or was owned by the spouses as joint tenants and therefore its total value is includible in his estate under Section 302 (a) or (e) of the Revenue Act of 1926.

STATUTES INVOLVED

A. B. O. & S. 8/1/42
Revenue Act of 1926, c. 27, 44 Stat. 9: *(inserted)*

SEC. 302. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

(a) To the extent of the interest therein of the decedent at the time of his death;

* * * *

(e) To the extent of the interest therein held as joint tenants by the decedent and any other

person, or as tenants by the entirety by the decedent and spouse, or deposited, with any person carrying on the banking business, in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have been received or acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth: *Provided*, That where such property or any part thereof, or part of the consideration with which such property was acquired, is shown to have been at any time acquired by such other person from the decedent for less than an adequate and full consideration in money or money's worth, there shall be excepted only such part of the value of such property as is proportionate to the consideration furnished by such other person: *Provided further*, That where any property has been acquired by gift, bequest, devise, or inheritance, as a tenancy by the entirety by the decedent and spouse, then to the extent of one-half of the value thereof, or, where so acquired by the decedent and any other person as joint tenants and their interests are not otherwise specified or fixed by law, then to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants;

* * * * *

Revised Code of Arizona (1928) :

265. *Joint account between husband and wife; payment to survivor.* Whenever a husband or wife open a joint account with any bank, and either one dies, such bank shall pay to the sur-

vivor the amount standing to their joint credit, and upon making such payment such bank shall be released from all further liability for such amount.

986. *Right of survivorship abolished.* Where two or more persons hold property jointly and one joint owner dies before severance, and the grant or devise does not expressly vest the estate in the survivor, the interest in the estate of the owner dying shall not survive to the remaining joint owners but shall descend to the heirs of the deceased joint owner as though his interest had been severed and ascertained.

2173. *Separate property; separate earnings of wife and children.* All property, both real and personal of the husband, owned or claimed by him before marriage and that acquired afterward, by gift, devise or descent, as also the increase, rents, issues and profits of the same, shall be his separate property, and all property, both real and personal of the wife, owned or claimed by her before marriage, and that acquired afterward by gift, devise or descent, as also the increase, rents, issues and profits of the same, shall be her separate property. The earnings and accumulations of the wife and her minor children in her custody while she has lived or may live, separate and apart from her husband, shall be the separate property of the wife.

STATEMENT

The facts as found by the Board of Tax Appeals may be summarized as follows:

The decedent, formerly a resident of the State of New York, moved to the State of Arizona in 1927 where he and his family resided until his death in 1939. (R.

16-17.) Upon moving to Arizona the decedent retired from all business activities and thereafter received no property from any occupation or employment. (R. 17.)

It was established that the estate of the decedent consisted of his originally separately acquired property, part of which consisted of his earnings prior to moving to Arizona and part an inheritance from his mother, the amount of the latter not shown in the record. (R. 20, 24.)

The decedent had established bank accounts in Arizona in which he alone made deposits. (R. 17.) Two of these were with a Tucson bank and both decedent and his wife signed the signature cards and either could draw on the accounts. The checking account was made to the credit of "Greenwood, C. H., or Albertine, Either or Survivor of Either". (R. 17-18.) Dividends on stock owned by the decedent were regularly deposited in this account and the decedent checked upon it in buying securities. (R. 18.) The savings account was made to the credit of "Greenwood, C. H., or Albertine". (R. 19-20.)

The decedent and his wife also rented a safe deposit box under a written contract, which provided "* * * hereby declare and represent that we own as joint tenants, with the right of survivorship, all the property of every kind or character now within said box and that all property which may be deposited therein by either or any of us shall be and is owned by us as such joint tenants". This contract is more fully set out in the Board's findings of fact. (R. 18-19.)

Decedent provided his wife a monthly allowance for

household expenses, making these payments to her himself. In his absence she issued checks on the checking account in the usual amount, and on a few occasions issued other checks in his absence. (R. 20.)

Upon the death of decedent the estate tax return listed assets valued at \$240,956.99. Of these, \$179,188.30 represented stock and bonds contained in the safe deposit box; \$26,708.31 represented deposits in banks, of which \$4,320.01 was in the savings account in the Tucson bank, in the name of "Greenwood, C. H., or Albertine", and \$3,553.52 was in the checking account in the name of "Greenwood, C. H., or Albertine, Either, or Survivor of Either"; and the remainder, \$18,834.78 represented savings accounts in decedent's name alone, in cities in Massachusetts, California and Arizona. (R. 19-20.)

The Board found as a matter of fact that the decedent referred to his property as being "half hers" and also referred to it as "community" property. (R. 21-23.) The Board also found that it was the wife's "understanding that half of the ownership of the bank accounts was hers, * * *". (R. 21.)

The administrator of the estate reported the property as community owned and the Commissioner computed the gross estate without allowing a deduction of one-half as returned under the claim of community property. (R. 23.)

The Board of Tax Appeals sustained the Commissioner on the ground that the decedent had established the ownership "jointly" with his wife rather than in "community" ownership.

SUMMARY OF ARGUMENT

Even if under Arizona law husband and wife may transmute the husband's separate property, acquired in another state, to community property of both spouses by their mutual understanding and intention to do so, the husband and wife in the case at bar cannot be held to have done so in the face of written agreements expressing their mutual understanding and intention to establish a joint tenancy. And this is true, even if, under the law of Arizona, the written agreements failed to establish a joint tenancy. The failure of the one would not establish the other in substitution thereof. As the Board of Tax Appeals found the evidence submitted insufficient to indicate community ownership, the property in question was either held in joint tenancy and includible in the husband's gross estate under the Revenue Act of 1926, Section 302 (e), or it remained the separate property of the husband throughout and includible in his gross estate in any event under Section 302 (a) of the Revenue Act of 1926.

ARGUMENT

I

Taxpayer has not shown that the decedent and wife transmuted his separate property into community property by an oral understanding and intention

It is not disputed that the property here involved was originally the separate property of the decedent. It is also not disputed that if the wife at any time acquired an interest in such property, she did so without having furnished any consideration for such interest. It is clear, therefore, that if no change in owner-

ship had been made up to the time of the decedent's death, or if the property were then held by the decedent and his wife as joint tenants with the right of survivorship, the total value of the property is required to be included in the decedent's gross estate. Section 302 (a) and (e) of the Revenue Act of 1926, *supra*. The petitioner does not contend otherwise, but argues that the ownership of the property had been converted into community ownership by mutual understanding and intention.

The Board has found that regardless of whether a husband and wife residing in Arizona may transmute the separate property of the husband into community property by oral agreement, there is, in this case, no sufficient showing of such a change to community ownership.

Counsel for petitioner states in his brief (p. 9), Point IV, that under the law of Arizona, where either husband or wife has separate property and it is their *intention* to treat such property as the community property of both, it becomes community property in accordance with their intention. Counsel also states that the laws of California and Washington may be taken as the law of Arizona on this point. We do not believe that the courts of either of those states have determined that intention alone is sufficient. In support of this point taxpayer cites *Estate of Kelsch*, 203 Cal. 613, 265 Pac. 214, 215. But the *Kelsch* case does not say that mere "intention" is sufficient. It says that a "mere verbal agreement" is sufficient. *Estate of Wahlefeld*, 105 Cal. App. 770, 288 Pac. 870, is also quoted (Br. 11) as authority for the fact that where

there was a meeting of the minds, either spoken or written words were sufficient. But that court found as a fact that there was a meeting of the minds and also that there was a fully executed oral agreement. Again in *Estate of Sill*, 121 Cal. App. 202, 204-205, 9 Pac. 2d 243, the appellate court held that an oral agreement or understanding need not be in any particular words "as long as it may be fairly inferred from all of the circumstances in evidence that a community interest was intended by the parties."

The decision of the Arizona court in *Rundle v. Winters*, 38 Ariz. 239, 245, 298 Pac. 929, does not as the petitioner contends stand for the principle that a husband and wife in Arizona may convert separate property into community property by merely having an intention to do so. That case involved the question whether the wife had a community interest in certain real estate and the facts disclosed that the separate funds of the husband and community funds derived from the operation of a business had been so commingled that it was difficult to state whether the property was purchased with separate or community funds. The court invoked the rule that when separate and community funds are commingled, the commingled funds are presumed to be community property, and it was in that connection that the court stated that when spouses have treated the income from their separate property as community income and it is their intent that it should become community property, the character of the income changes in accordance with their intention.

There has been no commingling of funds in this case. Neither the husband nor the wife had any personal

earnings of any kind subsequent to their change of domicile to Arizona, and all of the property here involved, consisting either of securities or bank accounts established with the income from the securities, is traceable to the separate ownership by the husband at the time that the Arizona domicile was established. Obviously, the deposit, of the income from the securities, in a joint bank account or in an account standing in the husband's name alone, affords no indication of an intent to change the status of either the income or the securities from separate property to community property.

The cases on which the petitioner relies are distinguishable from the case at bar on the simple, unescapable fact that in this case the Board was unable to find that the circumstances in evidence fairly supported the conclusion that the parties had established or had intended to establish community ownership. In none of the cases relied upon by the petitioner were the courts asked to balance comments of the parties in conversation against their clearly expressed written commitments. Cf. *Young v. Young*, 126 Cal. App. 306, 14 Pac. 2d 580. In the case at bar, the parties agreed in writing that the joint renting of the safe deposit box in which their securities were deposited should mean that they owned as joint tenants with the right of survivorship all of the property of every kind or character then within the box and all property which might subsequently be deposited therein. They had also agreed in writing that their checking account in the Tucson bank should be a joint account, payable to either or the survivor, and that the savings bank account in Tucson should be a joint account, subject to check by either.

All of the property here involved is clearly covered by one of these agreements.

As the Board stated in its opinion, there is no evidence indicating that the bank accounts in Massachusetts, Phoenix, Arizona, and Los Angeles, California, were covered by any separate agreement between the parties. Rather, the evidence was that *all* of the decedent's assets, including documents of title and certificates, were in the safe deposit box. In any case, it is a fair inference either that these accounts continued to be separate property, or that the other agreements placed this property in the same category with the rest.

Assuming, however, that the law of Arizona permits a complete change of character of property by a showing of vague references which might apply equally to other forms of ownership, we find no case holding that even a clearly established oral agreement takes precedence over the terms of a written agreement to the contrary. Certainly such statements as were relied upon here should not do so. As the Board pointed out, references to community ownership by the husband and wife may well have been attributable to the fact that in their minds, as laymen, any form of joint ownership in Arizona was *called* community ownership.

We submit that the general law of contracts prevails and the burden of showing that the written agreements were not what they purported to be would rest heavily on the parties or party who disclaimed it. The petitioner here not only had the burden of proving that an oral agreement for community ownership had been made but also that the written agreements did not mean what they purported to mean and that the oral agreement controls.

The Board of Tax Appeals has concluded that there was not a sufficient showing of the establishment of a community estate to overcome the presumption of correctness of the Commissioner's determination as to the ownership of the property. (R. 33.) The evidence submitted to the Board is not incorporated in the record so that the court's inquiry is confined to a determination as to whether, on the basis of the facts found by the Board, a contrary conclusion was necessarily required.

II

The property was either the separate property of the decedent or property held by the decedent and his wife as joint tenants: Hence the total value is required to be included in his gross estate under Section 302 (a) or Section 302 (c) of the Revenue Act of 1926

Whether or not the parties created a technical "joint tenancy" under the laws of Arizona, the fact remains that there was insufficiency of proof that they created a "community" interest.

Whether "joint tenancy" is favored or disfavored in Arizona is not determinative of what these parties did or tried to do. The type of proof offered which precludes claims of community ownership in California is relevant in the State of Arizona, particularly in view of the fact that the taxpayer has urged that we look to the laws of California and Washington generally in the absence of any material amount of litigation before the Arizona courts. California has held that written agreements as to safe deposit boxes and joint bank accounts similar to those here in question precluded claims of community ownership. *Estate of McCoin*, 9 Cal. App. 2d 480, 50 Pac. 2d 114; *Estate of Harris*, 169 Cal. 725, 147 Pac. 967; *Estate of Gurnsey*, 177 Cal.

211, 170 Pac. 402; *Young v. Young*, 126 Cal. App. 306, 14 Pac. 2d 580.

Even if an Arizona court were to hold that in the present case a joint tenancy could not legally be created it does not follow that something else entirely foreign to the written words of the parties was created. The agreements indicate an intention to create a joint tenancy and are inconsistent with any other intention.

The word "survivorship" is not beyond the average layman, even though the technicalities of the various legal tenancies in property may be. Survivorship is entirely foreign to the concept of community ownership, yet the parties here emphasized it.

The petitioner argues that joint tenancies in personal property are no longer legal in the State of Arizona. He points out that Section 1102 of the Revised Statutes of 1913 provided merely that where one joint owner dies before severance, his interest in the joint estate shall not survive to the remaining joint owners but shall descend to and be vested in the heirs and legal representatives, and that Sections 4708 and 4709 authorized the creation of joint tenancies in real property notwithstanding Section 1102. He argues that Section 986 of the 1928 Arizona Code providing that the right of survivorship be abolished where the grant or devise does not expressly vest the estate in the survivors, was based on Section 1102 and that since Section 986 uses the words "grant or devise", real property only is referred to.

Unless, however, a state statute specifically prohibits establishment of joint tenancies the general weight of authority indicates that they will be recognized, and

certainly in those states which permitted them by statute and failed to abolish them altogether. It is said in 33 Corpus Juris 900, at page 901:

* * * These statutes generally merely abridge or abolish joint tenancy with its incident of survivorship as it existed at common law, and do not prohibit or otherwise affect a joint tenancy, with the right of survivorship where the will, deed, or other instrument by which the estate is created, expressly declares or by necessary implication shows an intention to create such an estate, * * *.

It would seem that the State of Arizona has followed this general pattern in abolishing the right of survivorship in Section 986 of the Arizona Code.

The Supreme Court of Arizona, in *Estate of Sullivan*, 38 Ariz. 387, 393, 300 Pac. 193, said: "We should therefore presume that when a word, a phrase, or a paragraph from the 1913 Code is omitted from the Code of 1928, the intent is rather to simplify the language without changing the meaning, than to make a material alteration in the substance of the law itself." Under this interpretation it seems fair to reason that Section 986 of the 1928 Code did not abolish joint tenancies in personal property merely by use of the words "grant or devise," but that it abolished the right of survivorship in either personal or real property unless the estate were expressly vested in the survivor by terms of the instrument creating the tenancy.

In the case at bar, the agreement with respect to the safe deposit box and the agreement with respect to the checking account specifically provided that the survivor should take all. Hence, as to most of the property here

involved, there is no reason to assume that the wife could not have taken as survivor. The taxpayer argues that if the rental agreement is the grant within the meaning of the statute, it would follow that upon the removal of the certificate from the box, there would be a change in the title of the property, since oral joint tenancy could not exist under Arizona law, and all of the certificates and other documents have title in the name of the decedent alone. It may be that the agreement would govern even after the certificates were removed, but in any case, there is no basis for the theory that their removal would convert the certificates into community property, as distinguished from jointly owned property or the husband's separate property. They had not been acquired with community funds, and there was no agreement that they should be converted into community property upon their removal. In any case, we are concerned with securities in the box at the time of the decedent's death and as to them the written agreement controlled.

It should also be noted that in so far as the joint bank accounts are concerned, Section 265 of the Revised Code of Arizona (1928) provides that when a husband and wife open a joint account with any bank and either one dies, such bank shall pay to the survivor the amount standing to their joint credit. Hence, it does not appear that Section 986 has any application to the joint bank accounts here involved, and as to them the wife would take by survivorship.

But regardless of the law of Arizona as to joint tenancies, it is to be emphasized that under the facts of this case no presumption that a community estate was created or intended to be created can arise.

The taxpayer agrees that the property in question was originally the separate property of the husband. A "sizeable" portion of it was inherited and the rest was acquired as separate property before they became domiciled in Arizona. By the law of Arizona property inherited by one spouse is separate property, even though it be inherited during coverture while a resident of that state. Surely then, great care should be exercised in imputing an intention to spouses which their written agreements belie. In any event, if this Court does not find that the spouses did transmute the husband's separate property to community property it is unnecessary to determine whether they did or could create the attempted joint tenancy as the whole of the property would be includible in the husband's gross estate under Section 302 (a).

CONCLUSION

It is submitted that the Board of Tax Appeals was correct in its conclusion that the oral understanding relied upon by taxpayer was insufficient to overcome presumption of correctness of the Commissioner's determination. Its decision should, therefore, be affirmed.

Respectfully submitted,

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,

HELEN R. CARLOSS,

MURIEL PAUL,

Special Assistants to the Attorney General.

NOVEMBER, 1942.

No. 10217.

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

KENNETH R. GREENWOOD, Administrator of the Estate of
Charles H. Greenwood, Deceased,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

JOHN M. SCHWARTZ,
726 Bartlett Building, Los Angeles,
Attorney for Petitioner.

FILED

NOV 19 1942

PAUL P. O'BRIEN,

No. 10217.

IN THE
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FOR THE NINTH CIRCUIT

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Charles H. Greenwood, Deceased,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

While it appears that the substantial points of the respondent's argument are covered in the opening brief of the petitioner, it is believed that the following observations may serve to clarify the issues.

I.

Under point I of his argument the respondent contends that the petitioner has not shown that the decedent and his wife transmuted his separate property into community property, and therein he seems to take the position that the petitioner seeks to nullify a written agreement creating a

joint tenancy by a subsequent oral agreement mutually understood and intended. Such is not the case. What the petitioner seeks to make clear is that the written agreement as to the safe deposit box rental and the mutual understanding and intention of the parties are entirely consistent and in support of the community property theory under the laws of the State of Arizona. It is the petitioner's position that the safe deposit box rental agreement could in no such case create a joint tenancy as contemplated by the revenue laws. Joint tenancy as contemplated by the revenue laws is a tenancy wherein the grand incident is survivorship by which the entire tenancy remains to the survivor. (*U. S. v. Jacobs*, 306 U. S. 363.) It is submitted that in the instant case no such joint tenancy was created, and it is believed that points V, VI and VII of the petitioner's opening brief substantiate that position. It is obvious from the facts found by the board and discussed in petitioner's opening brief that the incentive of the decedent and his wife was equal ownership in community and not right of survivorship. Otherwise, the property would not have been referred to as community property and the decedent and his wife would not have made wills devising and bequeathing their respective shares. The written safe deposit box rental agreement clearly shows that equal ownership was intended, and, coupled with statements as to community property, it supports the petitioner's contention that a transmutation from the separate property of the decedent to the community property of both was effected.

II.

Under point II of his argument the respondent seems to argue that if the written safe deposit box rental agreement failed to establish a joint tenancy with right of survivorship, it failed to affect the status of the property in any respect and title remained, as before, in the decedent.

It is submitted that such argument is unsound in view of the express provisions of Section 986 of the Revised Code of Arizona, 1928. Under that section it is clear that where property held in joint tenancy does not pass to the survivor, the interest in the estate of the owner dying descends to the heirs of the deceased joint owner as though his interest had been severed and ascertained. In such case the instrument of title has not wholly failed and the owners are not restored in title to their former status. In effect, the instrument creates a tenancy in common and not a joint tenancy, and where the two joint owners are husband and wife and intend to hold in community rather than as tenants in common, a community estate is created. But even if a tenancy in common was created in the instant case, only one-half of the estate would be subject to federal estate tax.

It is a point worth stressing that when the safe deposit box rental agreement in the instant case was executed by the decedent and his wife, Section 1102 of the Revised Statutes of Arizona, 1913, was in force, and under that section it seems that a joint tenancy with right of survivorship could not be created in personal property even if the document of title expressly vested title in the survivor.

Section 986 of the Revised Code of Arizona, 1928, became effective July 1, 1929, and continued in effect at all times during the remainder of the decedent's life. But, as shown by the petitioner under Points V, VI and VII of his opening brief, even under this new section a joint tenancy was not created in the instant case. Both of these sections are set out in full in the petitioner's opening brief (pp. 14 and 15).

The decedent and his wife plainly agreed upon equal ownership and treated the property as community property, and it is clear that they intended community ownership and not joint tenancy in both or separate ownership in the decedent.

Respectfully submitted,

JOHN M. SCHWARTZ,

Attorney for Petitioner.

United States
Circuit Court of Appeals
For the Ninth Circuit.

MOUNT TIVY WINERY, INC., a Corporation,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Internal Revenue, First District, and UNITED STATES OF AMERICA,	Appellees.
CALIFORNIA WINERIES AND DISTILLERIES, INC., a Corporation,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Internal Revenue, etc., and UNITED STATES OF AMERICA,	Appellees.
FRESNO WINERY, INC., a Corporation, etc.,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Int. Revenue, et al.,	Appellees.
SANTA LUCIA WINERIES, INC., a Corporation,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Int. Revenue, et al.,	Appellees.
CHARLES DUBBS and SAMUEL CAPLAN, Co-partners doing business as ALTA WINERY AND DISTILLERY,	Appellants,
vs.	
JOHN V. LEWIS, Collector of Int. Revenue, et al.,	Appellees.
CALIFORNIA GROWERS WINERIES, INC., a Corporation,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Int. Revenue, et al.,	Appellees.
ST. GEORGE WINERY, a Corporation,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Int. Revenue, et al.,	Appellees.

Transcript of Record

Upon Appeals from the District Court of the United States
for the Northern District of California,
Southern Division

FILED
SEP 15 1942

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit.

MOUNT TIVY WINERY, INC., a Corporation,	Appellant,
vs.	
JOHN V. LEWIS, Collector of Internal Revenue, First District, and UNITED STATES OF AMERICA,	California Dis- Appellees.
CALIFORNIA WINERIES AND DISTILLERIES, INC., a Corporation,	Appellant,
vs.	
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Upon Appeals from the District Court of the United States
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Southern Division



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the Southern Division of the United States District Court for the Northern District of California.

No. 20473-S

MOUNT TIVY WINERY, INC., a California Corporation,

Plaintiff

v.

JOHN V. LEWIS, COLLECTOR OF INTERNAL REVENUE, FIRST CALIFORNIA DISTRICT, JOHN DOE, COLLECTOR OF INTERNAL REVENUE, FIRST CALIFORNIA DISTRICT, UNITED STATES OF AMERICA, FIRST DOE, SECOND DOE AND THIRD DOE,

Defendants.

COMPLAINT FOR REFUND OF TAXES
PAID ERRONEOUSLY AND ILLEGALLY
COLLECTED

Plaintiff complains of defendants, and for cause of action against defendants, alleges:

I.

That the defendants John Doe, First Doe, Second Doe and Third Doe, are the fictitious names of defendants sued herein whose true names are to the plaintiff unknown, and plaintiff asks that when such true names are ascertained this complaint may be amended by inserting such true names in the place and stead of such fictitious names.

II.

That at all times herein mentioned, plaintiff Mount Tivy Winery, Inc., was and now is a corporation duly organized and existing under and by virtue of the laws of the State of California, with a principal place of business at Fresno, County of Fresno, State of California.

III.

That at all times herein mentioned defendant John V. Lewis was the duly appointed, qualified and acting Collector of Internal Revenue in and for the First California District, Department of Internal Revenue, Treasury [1*] Department, United States of America, that at all such times said defendant John V. Lewis was acting for and on behalf of defendants in the discharge of his said duties as Collector of Internal Revenue.

IV.

That at all times herein mentioned, plaintiff Mount Tivy Winery, Inc., was engaged in the manufacture and production of wines intended for sale or for use in the manufacture or production of any article intended for sale at Fresno, County of Fresno, State of California, located in the First California District, Internal Revenue, United States of America, and in the Southern Division of the United States District for the Northern District of California.

*Page numbering appearing at foot of page of original certified Transcript of Record.

V.

That on January 11, 1934, an Act, known as the "Liquor Taxing Act of 1934" was enacted to raise revenue by taxing certain intoxicating liquors, therein set forth, by the 73rd Congress of the United States of America.

That Section 10 (c) of said Act reads as follows: "Sec. 10 (c). Upon all wines held by the producer thereof upon the day this title takes effect and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor tax equal to the amount, if any, by which the tax provided for under Section 8 of this title exceeds the tax paid upon the grape brandy or wine spirits used in the fortification of such wine," which Act by its expressed terms, became effective on the day following the enactment of said act, namely January 12, 1934.

VI.

That under the purported authority, and pursuant [2] to the provisions of the said Section 10 (c) of said Liquor Taxing Act of 1934, there was imposed upon and assessed against plaintiff as of January 12, 1934, a tax in the sum of Nineteen Thousand Four Hundred Ninety Six Dollars and thirty two cents (\$19,496.32) upon certain wines allegedly held by plaintiff on January 12, 1934, as the producer thereof; that at all times herein mentioned said wines upon which said tax was imposed upon and assessed against plaintiff except as hereinafter set

forth, were not held by plaintiff as the producer thereof, or at all, and there was no tax due, payable or unpaid to defendants except as hereinafter mentioned, from plaintiff upon said wines under Section 10 (c) of said Act; and, that therefore the assessment of said tax by defendants was and is illegal.

That on February 10, 1934, plaintiff paid to defendants at San Francisco, California, the sum of Two Thousand Dollars (\$2000.00) lawful money of the United States of America on account of said tax so imposed upon and assessed against plaintiff;

That under date of October 31, 1934, defendant John V. Lewis as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, notified plaintiff in writing to pay the unpaid balance of said tax so assessed and imposed upon plaintiff in the sum of Seventeen Thousand Four Hundred Ninety Six Dollars and thirty two cents (\$17,496.32), together with interest accruing thereon in the sum of One Thousand Five Hundred Fifty Eight Dollars and fifty three cents (\$1,558.53), then totaling the sum of Nineteen Thousand Fifty Four Dollars and eighty five cents (\$19,054.85);

That said written notice and demand for tax notified plaintiff that to avoid further penalty and interest, [3] the said sums must be paid to him as such Collector of Internal Revenue at San Francisco, California, within ten (10) days thereafter; that said defendant in said written notice and de-

mand for tax, demanded further that immediate payment of said sum be made by plaintiff to said defendant as such Collector of Internal Revenue, under the provisions of said Section 10 (c) of the Liquor Taxing Act of 1934, referred to in said notice as Distilled Spirits Floor Tax.

VII.

That, under protest, plaintiff, pursuant to said notice and demand for tax paid to defendant John V. Lewis, as such Collector of Internal Revenue at his office in said First California District, the sum of Nineteen Thousand Fifty Four Dollars and eighty five cents (\$19,054.85) on or about the 10th day of November, 1934, as demanded, aggregating the total sum of Twenty One Thousand Fifty Four Dollars and eighty five cents (\$21,054.85) paid to defendants, representing tax imposed and accrued interest penalties.

That save and except the sum of Five Thousand Six Hundred Thirty Five Dollars and fifty two cents (\$5635.52) no part of the said sum of Twenty One Thousand Fifty Four Dollars and eighty five cents (\$21,054.85) paid to said defendant, was due lawfully to defendants under the provisions of said Liquor Taxing Act of 1934 Sec. 10 (c) thereof, and that the said sum of Fifteen Thousand Dollars Four Hundred and Nineteen Dollars and thirty three cents (\$15,419.33) was erroneously paid by plaintiff to defendants and was unlawfully collected by defendants from plaintiff thereunder.

VIII.

That, within three years after filing a return with defendants, and within two years from the time of [4] payment by plaintiff to defendants of the said sum of Fifteen Thousand Four Hundred Nineteen Dollars and thirty three cents (\$15,419.33) as aforesaid, a claim for refund was thereafter duly and regularly presented by, for, and on behalf of plaintiff to defendants, in the manner, and as provided by law, and the rules and regulations of the Treasury Department, Department of Internal Revenue of defendant, United States of America.

That plaintiff is informed and believes, and upon the ground of such information and belief alleges: that within two years last past said claim for refund of said taxes and penalties so erroneously paid by plaintiff as aforesaid, to, and illegally collected by defendants, was disallowed and rejected by defendants; and, that within two years last past defendants notified plaintiff by registered mail of the disallowance and rejection of said claim for refund of said taxes and penalties.

IX.

That plaintiff is informed and believes and upon the ground of such information and belief alleges that defendant John V. Lewis resigned as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, since the rejection of the claim

for refund of taxes and penalties erroneously paid by plaintiff and unlawfully collected by defendants, hereinabove set forth, and, that said defendant, John V. Lewis is no longer engaged or employed by defendant United States of America as such Collector of Internal Revenue, First California, Internal Revenue, Treasury Department, United States of America.

Wherefore, plaintiff prays etc.

And for a second, separate and distinct cause of [5] action against defendants, plaintiff alleges:

I.

Plaintiff repleads Paragraphs I, II, III, IV, V, VI, VIII, and IX of plaintiff's first cause of action, in each and every particular as if said paragraphs were set forth and repeated herein in full, in this, plaintiff's second cause of action against defendants.

II.

That, under protest, plaintiff, pursuant to said notice and demand for tax, paid to defendant John V. Lewis as Collector of Internal Revenue at his office in the First California District the sum of Fifteen Thousand Four Hundred and Nineteen Dollars and Thirty Three Cents (\$15,419.33) as demanded on or about the 10th day of November, 1934.

III.

That at all times herein mentioned section 10(c) of the Liquor Taxing Act of 1934, and the tax

therein provided, was and is, in, and a, violation of Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4 of the Constitution of the United States of America, and was and is unconstitutional, in:

1—that said Section provides for the levy assessment and collection of a direct tax, “Upon all wines held by a producer * * * ” based upon ownership rather than an excise tax upon the manufacture, use or sale of such wines; and

2—that said tax, therein imposed, was not apportioned among the several states, in proportion to the Census or Enumeration as provided, permitted and required under the aforementioned provisions of Article I of the Constitution of the United States of America. [6]

IV.

That no part of the said sum of Fifteen Thousand Four Hundred and Nineteen Dollars and Thirty Three Cents (\$15,419.33) paid to defendants was due lawfully under the provisions of the Liquor Taxing Act of 1934, Section 10(c) thereof, and the levy, assessment and collection of said sum from plaintiff by defendants was and is a violation of the aforementioned provisions of Article I, of the Constitution of the United States of America, and was and is illegal and unconstitutional.

Wherefore, plaintiff demands judgment against defendants, and each of them, as follows:

1. adjudging that the said sum of Fifteen Thousand Four Hundred and Nineteen Dollars and Thirty Three Cents (\$15,419.33) was erroneously paid by plaintiff and illegally collected by defendants under the purported authority allegedly conferred upon defendants pursuant to and under the provisions of Section 10(c) of the Liquor Taxing Act of 1934, and under the provisions of the Constitution of the United States of America; and

2. Requiring defendants, and each of them, to repay forthwith the said sum of Fifteen Thousand Four Hundred and Nineteen Dollars and Thirty Three Cents (\$15,419.33) erroneously paid by plaintiff and illegally collected by defendants under the provisions of Section 10(c) of the Liquor Taxing Act of 1934 and in violation of the provisions of the Constitution of the United States of America, together with interest thereon, as provided by law, at the rate of six (6) per cent per annum, from the 10th day of November, 1934, until paid in full; and

3. for such other and further relief as to this Court may seem meet and equitable.

ROBERT H. FOUKE,

Attorney for Plaintiff.

[Endorsed]: Filed July 28, 1938. [7]

[Title of District Court and Cause.]

ANSWER OF DEFENDANT JOHN V. LEWIS
TO COMPLAINT

ANSWER TO FIRST CAUSE OF ACTION
AGAINST SAID DEFENDANT

Defendant admits the allegations contained in paragraphs II and V and the allegation that said defendant John V. Lewis is no longer engaged or employed by the United States of America as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, in paragraph IX of the first cause of action of the Complaint, and denies each and every other allegation contained in the first cause of action of the Complaint. [8]

ANSWER TO SECOND CAUSE OF ACTION
AGAINST SAID DEFENDANT

First Defense

The second cause of action of said Complaint fails to state a claim against defendant upon which relief can be granted.

Second Defense

Defendant admits the allegations contained in paragraphs II and V and the allegation that said defendant John V. Lewis is no longer engaged or employed by the United States of America as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, in paragraph IX of the

first cause of action of the Complaint incorporated by reference in the second cause of action of the Complaint; and denies each and every other allegation contained in the second cause of action of the Complaint.

Wherefore the defendant prays:

1. That the plaintiff take nothing by reason of its action;

2. That the defendant be dismissed with his costs of suit incurred herein;

3. For such other and further relief as to this Court may seem just and equitable in the premises.

Dated: May 1, 1939.

FRANK J. HENNESSY,

United States Attorney for
the Northern District of
California, Attorney for the
Defendant John V. Lewis.

Receipt of Service.

[Endorsed]: Filed May 1, 1939. [9]

[Title of District Court and Cause.]

ANSWER OF DEFENDANT UNITED STATES
OF AMERICA TO COMPLAINT

ANSWER TO FIRST CAUSE OF ACTION
AGAINST SAID DEFENDANT

Defendant admits the allegations contained in paragraphs II and V and the allegation that said

defendant John V. Lewis is no longer engaged or employed by the United States of America as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, in paragraph IX of the first cause of action of the Complaint, and denies each and every other allegation contained in the first cause of action of the Complaint. [10]

ANSWER TO SECOND CAUSE OF ACTION AGAINST SAID DEFENDANT

First Defense

The second cause of action of said Complaint fails to state a claim against defendant upon which relief can be granted.

Second Defense

Defendant admits the allegations contained in paragraphs II and V and the allegation that said defendant John V. Lewis is no longer engaged or employed by the United States of America as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, in paragraph IX of the first cause of action of the Complaint incorporated by reference in the second cause of action of the Complaint; and denies each and every other allegation contained in the second cause of action of the Complaint.

Wherefore the defendant prays:

1. That the plaintiff take nothing by reason of its action;

2. That the defendant be dismissed with its costs of suit incurred herein;

3. For such other and further relief as to this Court may see just and equitable in the premises.

Dated: May 1, 1939.

FRANK J. HENNESSY,

United States Attorney for
Northern District of Cali-
fornia, Attorney for the
Defendant United States
of America.

Receipt of Service.

[Endorsed]: Filed May 1, 1939. [11]

[Title of District Court and Cause.]

STIPULATION OF FACTS

It Is Hereby Stipulated by and between Mount Tivy Winery, Inc., the plaintiff, and John V. Lewis and the United States of America, two of the defendants named above, that the recital of facts hereinafter contained may be deemed true for all purposes in connection with the above entitled cause, as follows:

I.

That plaintiff, the Mount Tivy Winery, Inc., was [12] at all times mentioned in the complaint and herein, and now is a corporation duly organized and existing under and by virtue of the laws of the

State of California; and at all times mentioned herein plaintiff had its principal place of business at 600 Rowell Building, located in the City of Fresno, County of Fresno, State of California, and its principal place of business is now located at LacJac, County of Fresno, State of California, in the Northern Division of the Southern District of California, with mailing address as P. O. Box 1288, Fresno, Fresno County, California.

II.

That plaintiff, the Mount Tivy Winery, Inc., was at all times mentioned in the complaint and herein, engaged in the manufacture, production and sale of wines intended for sale or for use in the manufacture or production of articles intended for sale at Bonded Winery No. 3620 located at LacJac, about 2.3 miles east of Parlier Post Office, Fresno County, State of California, within the First California District, Internal Revenue, United States of America and in the Northern Division of the Southern District of California.

III.

That on July 5, 1933, the defendant John V. Lewis was duly appointed and qualified as the Collector of Internal Revenue in and for the First California District, Department of Internal Revenue, Treasury Department, United States of America, and thereafter, at all times mentioned in the complaint and herein, was the duly appointed,

qualified and acting Collector of Internal Revenue, Treasury Department, United States of America, and acted and continued to act as such until March 7, 1938, when he resigned. [13]

IV.

That the Fidelity Warehouse Corporation is a corporation duly organized and existing under and by virtue of the laws of the State of California, and at all times mentioned in the complaint and herein, owned and operated a public warehouse business known as Public Bonded Storeroom No. 3728, in the warehouse located at LacJac contiguous with and adjoining the Bonded Winery No. 3620 owned and operated by plaintiff, Mount Tivy Winery, Inc., under the authority of and pursuant to the laws of the State of California and Treasury Decision No. 19 and General Circular No. 141, approved September 16, 1933, attached hereto as Exhibit "A".

That the Fidelity Warehouse Corporation made application upon the form attached hereto, entitled Exhibit "B", to the Supervisor of Permits, Bureau of Industrial Alcohol, under the laws and regulations governing the establishment of bonded wineries and storerooms, for a permit to establish Public Bonded Storeroom No. 3728, and upon the issuance thereof to it, a copy of which is attached hereto as "Exhibit "C", qualified and gave blanket bonds, in the forms attached, in the maximum sum of \$100,000.00 on Form 1530A, entitled Exhibit

“D”, and on Form 699A, entitled Exhibit “E”, to the defendant United States of America; That in addition to this, said Fidelity Warehouse Corporation was obliged to and did render monthly reports to the Supervisor of Permits on Form 702, attached hereto, entitled “Exhibit “F”, accounting for all wines received, stored and removed from the bonded storeroom premises. [14]

V.

That on November 13, 1933 a Field Warehouse Storage Agreement was executed in writing by and between plaintiff and the Fidelity Warehouse Corporation which provided, among other things, that the Fidelity Warehouse Corporation should furnish plaintiff all field warehouse services necessary to plaintiff's business and that plaintiff should employ the Fidelity Warehouse Corporation for all field warehouse services required by plaintiff and, further, that plaintiff would furnish warehouse premises sufficient in number and capacity to provide adequate storage space for all wine to be warehoused, so located and constructed as to adequately secure the safety of the wine, and to lease to the Fidelity Warehouse Corporation all premises owned or controlled by plaintiff in which field warehousing was to be conducted. A copy of this Field Warehouse Storage Agreement is attached hereto as Exhibit “G”.

That under said Agreement the Fidelity Warehouse Corporation agreed, among other things, for

the consideration therein expressed and subject to the terms and conditions therein contained: (1) to maintain a public warehouse in and upon the premises leased by plaintiff to said corporation; (2) to furnish to plaintiff all Field Warehouse services necessary to plaintiff's business; (3) to place its bonded agent and/or bonded watchman in charge of said warehouses(s) and leased premises; and (4) to issue Field Warehouse Receipts upon the merchandise or property which plaintiff may store therein or thereon; provided, however: (a) that the Fidelity Warehouse Corporation shall be free from all liabilities for taxes, assessments, charges or penalties levied, assessed or imposed by federal, state, county or municipal government, or by any other quasi-public or governmental [15] agency upon or in respect of the wines warehoused under the terms of the said agreement; (b) that plaintiff agreed to render all reports required of plaintiff or said corporation, or either of them, in respect to the commodities warehoused, by any and all governmental agencies; and (c) that at the option of said Fidelity Warehouse Corporation, it could pay all taxes, assessments, charges or penalties, service, blend, fortify, rack, handle and care for the warehoused wine, and render all reports, at the expense of plaintiff, in the event plaintiff failed to do so as agreed in said agreement.

VI.

That on November 13, 1933 plaintiff, pursuant to the provisions of the Field Warehouse Storage

Agreement and as authorized by Treasury Decision No. 19, approved September 16, 1933, executed in writing a field warehouse lease which leased to the Fidelity Warehouse Corporation a portion of a building, and all containers therein, for use as a warehouse. The building so leased was adjacent to the same premises as plaintiff's Bonded Winery No. 3620, bore the same post office box number and was contiguous with and adjoining the structures of plaintiff's Bonded Winery No. 3620. This portion of a building was registered as Public Bonded Storeroom No. 3728. A copy of the Field Warehouse Lease is attached hereto as Exhibit "H".

That at all times mentioned in the complaint and herein, said leased premises were in the lawful possession and under the control of the Fidelity Warehouse Corporation under and subject to the terms and conditions of said lease.

That Exhibits "G" and "H" were executed prior to the passage of Section 10 (c) of the Liquor Taxing Act of 1934, and that at the time of the execution of said agreements [16] the parties thereto did not know that Section 10 (c) of the Liquor Taxing Act of 1934 was contemplated or would be enacted into law; and that neither before nor at the time of the execution of said agreements, did either or both of the parties thereto, negotiate, contemplate or execute said agreements in order to avoid or evade the provisions of Section 10 (c) of the Liquor Taxing Act of 1934.

VII.

That during the months of November and December, 1933, and before January 12, 1934, plaintiff removed 484,000 gallons of fortified wine from its Bonded Winery No. 3620 and stored it in Public Bonded Storeroom No. 3728 and, in writing, requested the Fidelity Warehouse Corporation to issue four (4) original Wine Warehouse Receipts, negotiable in form, for 484,000 gallons of wine, to the Bank of America National Trust and Savings Association, Fresno Branch, or order, (herein referred to as Bank) as follows: one for 211,000 gallons dated November 29, 1933, numbered 01304 (copy attached hereto as Exhibit "I"; the second for 123,000 gallons dated December 4, 1933, numbered 01307 (copy attached hereto as Exhibit "J"); the third for 119,000 gallons dated December 22, 1933, numbered 01312 (copy attached hereto as Exhibit "K"; and the fourth for 31,000 gallons dated January 6, 1934, numbered 01316 (copy attached hereto as Exhibit "L"; which receipts were issued and executed in the name of and were delivered at the request of plaintiff on said dates in accordance with said request to said Bank by the Fidelity Warehouse Corporation in accordance with and pursuant to the authority contained in its Articles of Incorporation and By-laws and the laws of the State of California.

That thereafter and prior to January 12, 1934, [17] several promissory notes in the form of Exhibit "M", attached hereto and made a part hereof,

were prepared by the Bank and were executed by plaintiff at the request and to the order of the Bank, and plaintiff on December 22, 1933, entered into a collateral agreement with the Bank, a copy of which said agreement is attached hereto as Exhibit "M1".

That at all times prior to the sale or disposition thereof and the wine covered thereby, said warehouse receipts were in the name and in the possession and under the control of the Bank of America National Trust and Savings Association, as herein set forth.

VIII.

That the 484,000 gallons of wine so removed and stored was the first wine removed to and stored in Public Bonded Storeroom No. 3728 and remained the only wine so removed and stored by plaintiff or anyone else up to and including January 12, 1934.

IX.

That all wine delivered to the Fidelity Warehouse Corporation by plaintiff covered by said warehouse receipts, negotiable in form, was released subsequently thereunder by said Bank by the execution and delivery to the Fidelity Warehouse Corporation by said Bank of an "Order for Warehouse Release" upon the form attached hereto as Exhibit "N".

X.

That prior to the Liquor Taxing Act of 1934 sec-

tion 612 of the Revenue Act of 1918, as amended, read as follows:

“Sec. 612. (Revenue Act of 1918). That under such regulations and official supervision and upon the giving of such notices, entries, bonds, and other security the Commissioner, with the approval of the Secretary, may prescribe, any producer of wines defined under the [18] provisions of this title, may withdraw from any fruit distillery or special bonded warehouse grape brandy, or wine spirits, for the fortification of such wines on the premises where actually made; Provided, That there shall be levied and assessed against the producer of such wines a tax (in lieu of the internal-revenue tax now imposed thereon by law) of 10 cents per proof gallon of grape brandy or wine spirits whenever withdrawn and hereafter so used by him in the fortification of such wines during the preceding month, which assessment shall be paid by him within ten months from the date of notice thereof; Provided further, That nothing contained in this section shall be construed as exempting any wines, cordials, liqueurs, or similar compounds from the payment of any tax provided for in this title.”

That on January 11, 1934, the 73d Congress of the United States of America enacted an act known as the “Liquor Taxing Act of 1934” to raise revenue by taxing certain intoxicating liquors, and for the other purposes therein set forth.

That Section 8 of Title I of said Act reads as follows:

“Sec. 8. Section 612 of the Revenue Act of 1918, as amended (relating to the tax on grape brandy and wine spirits withdrawn and used in the fortification of wines) (U.S.C., Sup. VI, title 26, sec. 1301), is amended by striking out ‘10 cents per proof gallon’ and inserting in lieu thereof ‘20 cents per proof gallon’ ”.

That Section 10 (c) of Title I of said Act reads as follows:

“Sec. 10 (c). Upon all wines held by the producer thereof upon the day this title takes effect and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor tax equal to the amount, if any, by which the tax provided for under section 8 of this title exceeds the tax paid upon the grape brandy or wine spirits used in the fortification of such wine.”

which Act by its expressed terms became effective on the day following the enactment of said Act, namely, January 12, 1934.

That all taxes therein provided were, by the terms of said Act, due forthwith and were payable 30 days after the effective date of said Act.

XI.

That the 484,000 gallons of fortified wine evidenced by warehouse receipts, stored in said ware-

house on January 12, 1934, [19] had been produced by plaintiff at its Bonded Winery No. 3620 prior to January 11, 1934 and contained 147,927.08 proof gallons of brandy previously withdrawn from a distillery and previously used in the fortification of wine produced by plaintiff; That prior to January 11, 1934 and at the time of the withdrawal and use of said brandy in fortifying said wine, there had been assessed against plaintiff a tax at the rate of 10c per proof gallon as required by the Internal Revenue Law of 1918, as amended; upon which wine there was due from plaintiff an additional tax under the provisions of Section 10 (c) of the Liquor Taxing Act of 1934 (at the rate of 10c per proof gallon of brandy used in fortification) in the sum of \$14,792.71 upon 147,927.08 proof gallons of brandy, provided said wine was then "held" by plaintiff as the producer thereof and said Act was valid in connection therewith.

XII.

That on January 2, 1934 plaintiff had in its Bonded Winery No. 3620, 220,297.34 gallons of fortified wine. This wine had been produced by plaintiff in its winery and contained 61,863.88 proof gallons of brandy previously withdrawn from a distillery for the fortification of wine previously produced by plaintiff and upon which brandy plaintiff had been assessed a tax at the rate of 10c per proof gallon as required by the Internal Revenue Law of 1918, as amended, and upon which wine

there was due from plaintiff a tax under the provisions of Section 10(c) of the Liquor Taxing Act of 1934 (at the rate of 10c per proof gallon of brandy used in fortification) in the sum of \$6,186.39, provided said wine was then "held" by plaintiff as the producer thereof and said Act was valid in connection therewith; That no claim for abatement or refund was made for said latter sum, consequently plaintiff is not entitled to recover the same in this action.

XIII.

That the said 484,000 gallons of fortified wine were de- [20] livered to the warehouse company for storage in Public Bonded Storeroom No. 3728 by plaintiff prior to January 11, 1934 and were intended for sale and were sold, as herein set forth; That the Bank, from time to time, extended unsecured bank credits to plaintiff; That, as the wine was produced and delivered by plaintiff to the Warehouse Company, warehouse receipts, negotiable in form, covering such wine were issued in the name, and to the order of, and were delivered to and received by the Bank; That, as hereinbefore set forth, plaintiff executed promissory notes payable to the Bank on the form attached hereto as Exhibit "M", and made the collateral agreement attached hereto as Exhibit "M¹"; That the Bank extended bank credits to plaintiff prior to the actual issuance of said warehouse receipts to the Bank, or its order; That thereafter plaintiff secured a prospective purchaser for the wine and notified the

Bank of the proposed terms of sale; That in the event the purchaser and the terms of sale were satisfactory to the Bank the sale was consummated with the approval of the Bank upon a cash or credit basis; That, as part of the same general sale transaction, the Bank executed and delivered to the Fidelity Warehouse Corporation an "Order for Warehouse Release" in the form of Exhibit "N" attached, covering the wine sold to the purchaser and either delivered the said warehouse receipts to said warehouse company for cancellation, or for the endorsement thereon of the amount of the wine sold or for the issuance of a new warehouse receipt, negotiable in form, in the name and to the order of the Bank, for the remaining unsold quantity of wine covered by said warehouse receipt, and re-delivery to the Bank of the cancelled, endorsed or new receipt, or delivered both said order and warehouse receipt to the purchaser or the [21] warehouse company subject to the purchaser's further order or endorsement.

That subject to the order of the purchaser, wine sold was thereafter prepared for shipment to the purchaser, or order, on the warehouse promises by the plaintiff and an entry made on Form 702, a report filed monthly with defendant, indicating the release of such wine to plaintiff; and that such wine was received by plaintiff for the purposes mentioned for the account of the purchaser and subject to the order of the purchaser.

XIV.

That, except as herein set forth, the Bank never negotiated said warehouse receipts.

That at all times herein mentioned all of said wine, except as otherwise specified, was in the physical possession and under the physical control of the Fidelity Warehouse Corporation and was held by it as a Bonded Warehouseman in its public Bonded Storeroom No. 3728 under the laws of the State of California, the United States of America, and the rules and regulations of the Treasury Department, including T. D. #19 *supra*, and the agreements between it and plaintiff, plaintiff and the Bank and it and the Bank.

That in the regular course of business, and in accordance with the agreement executed by plaintiff with the Fidelity Warehouse Corporation, plaintiff, from time to time, manufactured and delivered to the Fidelity Warehouse Corporation the wine herein referred to, at the premises leased to the Fidelity Warehouse Corporation by plaintiff; That all wine so delivered to the Fidelity Warehouse Corporation was placed in storage tanks located in and upon the leased premises; That signs were placed over and outside the entrances and inside the leased premises to the effect [22] that said leased premises was the registered Public Bonded Storeroom No. 3728 of the Fidelity Warehouse Corporation; That upon receipt of the wine from plaintiff, said Warehouse Company caused to be placed upon the tanks in which the wine was stored, stock cards showing that

the wine was warehoused to said Bank, the description of the wine, the date of warehousing, the negotiable warehouse receipt number issued against the wine, and the quantity and quality of the wine therein stored; That locks were placed upon all entrances to the leased premises by the Fidelity Warehouse Corporation and the key to each of said locks was in the possession and was retained by the agent of the Fidelity Warehouse Corporation in charge of the leased premises; That at all times herein mentioned the Fidelity Warehouse Corporation caused to be employed its bonded agent to whom detailed printed instructions were given as to his duties; That the salary of said bonded agent was paid by the Fidelity Warehouse Corporation; That plaintiff was not permitted access to the leased premises except through the bonded agent of the Fidelity Warehouse Corporation in accordance with the terms of said written agreement herein referred to, and then only under the observation and supervision of the bonded agent of the Fidelity Warehouse Corporation; That the warehouse was opened and closed by the bonded agent who kept it locked at all times that he was not personally there, and said bonded agent received and delivered all merchandise at the leased premises.

That in accordance with the provisions of paragraph nine of the Field Warehouse Storage Agreement, "Exhibit "G", and in accordance with an understanding between the plaintiff and the Fidelity Warehouse Corporation pursuant thereto, the plain-

tiff was, from time to time, permitted to have access to [23] the said bonded storeroom for the purpose of servicing and caring for said wine during the period said wine was stored in said bonded storeroom.

XV.

That the Bank did not pay personal property taxes or any taxes imposed by the Liquor Taxing Act of 1934 upon the wine covered by the warehouse receipts; That all taxes thereon were paid by plaintiff in accordance with and pursuant to the provisions of the agreement attached hereto entitled Exhibit "G" executed by and between plaintiff and Fidelity Warehouse Corporation.

XVI.

That on January 11, 1934 the Commissioner of Internal Revenue instructed the defendant John V. Lewis with relation to the collection of the tax imposed by Section 10 (c) as set out in A & C, mimeograph Coll. No. 4132 dated January 11, 1934, attached hereto as Exhibit "O"; That in accordance therewith and pursuant thereto said defendant John V. Lewis, for and on behalf of defendant United States of America, caused to be delivered to Plaintiff a mimeographed circular dated January 15, 1934 entitled "Floor Tax on Distilled Spirits, Wines, Cordials, etc.", a copy of which is attached hereto as Exhibit "P".

XVII.

That pursuant thereto, and in the belief that a tax was due defendants, on February 6, 1934 plain-

tiff, pursuant to such belief and the further belief that it was legally required, returned to defendant John V. Lewis an Inventory and Return on Form 756, a form prepared and supplied by defendant to plaintiff, a copy of which is attached hereto as Exhibit "Q" showing 659,106.97 gallons of wine containing 194,963.16 proof gallons of brandy on hand, upon which a tax was believed [24] to be due of \$19,496.32.

XVIII.

That on February 10, 1934, said plaintiff paid to defendant John V. Lewis as such Collector of Internal Revenue at his office in San Francisco, California, the sum of \$2000.00.

That on February 17, 1934 plaintiff addressed a letter to the defendant John V. Lewis, Collector of Internal Revenue, San Francisco, California, in which it is stated that the \$2000.00 cash paid to said Collector of Internal Revenue "represents a tax liability on brandy in fortified wines in the hands of the producer, Mount Tivy Winery, Inc." and that "the remaining balance of \$17,496.32 represents tax on brandy in fortified wines held by the Fidelity Warehouse Company, who held full possession and control of said wine and brandy as bailee or warehouseman for the Bank of America." In said letter, plaintiff "protests the payment of any tax assessed or levied against said wine or brandy held by the Fidelity Warehouse Corporation"....."based on the fact that said wines and brandy"....."were not

held by the producer on the date the Internal Liquor Taxing Act of 1934 became effective." (Copy of letter attached as Exhibit "R".

XIX.

That in February 1934 the defendant John V. Lewis prepared and forwarded to the Commissioner of Internal Revenue, Washington, D. C., an assessment list showing a tax due under the provisions of Section 10(c) of the Liquor Taxing Act of 1934 from plaintiff in the amount of \$19,496.32, the amount returned by plaintiff on its Inventory and Return Form No. 756 on February 6, 1934, which sum was assessed by the Commissioner of Internal Revenue on April 11, 1934. The assessment list also showed the payment of \$2000.00 and the [25] balance due as \$17,496.32.

XX.

That on May 14, 1934 plaintiff filed claim in abatement of \$14,160.99 of the tax assessed against plaintiff. (Copy of claim attached as Exhibit "S".)

XXI.

That on August 10, 1934 plaintiff filed claim in abatement of \$3,335.33 of the taxes reported as due by plaintiff on February 10, 1934, a copy of which claim is attached as Exhibit "T". Of the original sum reported as due by plaintiff on February 10, 1934, plaintiff had thus paid the sum of \$2000.00 and claimed abatement of the balance of \$17,496.32.

XXII.

That on October 18, 1934 the Commissioner of Internal Revenue rejected plaintiff's claim in abatement of \$14,160.99 of the taxes by letter dated October 18, 1934.

XXIII.

That on October 24, 1934 the Commissioner of Internal Revenue rejected plaintiff's claim in abatement of \$3,335.33 of the taxes by letter dated October 24, 1934.

XXIV.

That under date of October 31, 1934 defendant John V. Lewis as Collector of Internal Revenue, First California District, Internal Revenue, Treasury Department, United States of America, notified plaintiff in writing to pay said tax in the sum of Seventeen Thousand Four Hundred Ninety-Six Dollars and thirty-two cents (\$17,496.32), the unpaid balance so assessed and imposed upon plaintiff, together with interest accruing thereon in the sum of One Thousand Five Hundred Fifty-eight Dollars and fifty-three cents (\$1,558.53), totaling the sum of Nineteen Thousand Fifty-four Dollars and [26] eighty-five cents (\$19,054.85), and that to avoid further penalty and interest, the sum of Nineteen Thousand Fifty-four Dollars and eighty-five cents (\$19,054.85) must be paid to him as such Collector of Internal Revenue at San Francisco, California, within ten (10) days thereafter; That said defendant in said written notice and demand for tax, de-

manded further that immediate payment of said sum be made by plaintiff to said defendant as such Collector of Internal Revenue, under the provisions of said Section 10 (c) of the Liquor Taxing Act of 1934, referred to in said notice as Distilled Spirits Floor Tax.

XXV.

That, under protest, plaintiff, on November 10, 1934, pursuant to said notice and demand for tax, paid to Defendant John V. Lewis, as such Collector of Internal Revenue at his office in said First California District the sum of \$17,496.32, the unpaid balance of the assessed tax, and the sum of \$1,558.53, accrued interest on said unpaid balance of said tax, a total of \$19,054.85. This amount, together with \$2000.00 paid to defendant on February 10, 1934, makes a grand total of \$21,054.85, as evidenced by Collector's stamp on Form 1 and Form 17, Notice and Demand for Tax, attached hereto as Exhibits "U" and "V".

XXVI.

That on August 28, 1935 plaintiff filed with the defendant John V. Lewis a claim for the refund of \$15,419.33.

XXVII.

That on July 29, 1936 the Commissioner of Internal Revenue rejected plaintiff's claim for refund, and on that date sent plaintiff a notice of the disallowance of the claim by registered mail. [27]

XXIX.

Each party hereby reserves the right to object to a consideration of any statement of fact **contained** in this Stipulation upon the ground that the same is incompetent, irrelevant or immaterial.

Any facts not covered by this Stipulation but which can be ascertained from the pleading, may be given consideration if relevant and not inconsistent with the stipulated facts.

Dated: This 30th day of April, 1941.

FRANK J. HENNESSY,

Per W. F. M.,

Attorney for defendants John
V. Lewis and the United
States of America.

ROBERT H. FOUKE,

Attorney for the plaintiff,
Mount Tivy Winery, Inc.

[Endorsed]: Filed Apr. 30, 1941. [28]

LIST OF EXHIBITS

Mount Tivy Winery, Inc.

Exhibit No.

“A” Treasury Decision No. 19—Gen’l. Circular No. 141

“B” Application for Permit Form 1404

“C” Permit to operate—Form 1405

“D” Blanket Bond—Form 1530A

“E” Blanket Bond—Form 699A

- “F” Monthly Report—Form 702
- “G” Field Warehouse Storage Agreement
- “H” Field Warehouse Lease
- “I” Warehouse Receipt No. 01304
- “J” Warehouse Receipt No. 01307
- “K” Warehouse Receipt No. 01312
- “L” Warehouse Receipt No. 01316
- “M” Promissory Note
- “M-1” Collateral Agreement
- “N” Order for Warehouse Release
- “O” A & C Mimeo Coll. No. 4132
- “P” Mimeo Letter “Floor Tax on Distilled
Spirits, Wines, Etc.
- “Q” Inventory & Return—Form 756
- “R” Letter of Protest
- “S” Claim in Abatement
- “T” Claim in Abatement
- “U” Receipt for payment of Taxes—Form 1
- “V” Notice and Demand for Tax—Form 17.

[29]

[Title of District Court and Cause.]

SUPPLEMENTAL STIPULATION OF FACTS

It Is Hereby Stipulated by and between Mount Tivy Winery, Inc., the plaintiff, and John V. Lewis and the United States of America, two of the defendants above named, that the recital of facts hereinafter contained supplements the Stipulation

of Facts previously filed herein and may be deemed true for all purposes in connection with the above [30] entitled cause.

On February 28, 1939 plaintiff forwarded to the Honorable Frank Murphy, Attorney General of the United States, a copy of the Complaint and Summons in the above entitled action, which was received by the Attorney General of March 6, 1939.

Dated: This 30th day of October, 1941.

FRANK J. HENNESSY

Attorney for defendants John V.
Lewis and the United States of
America.

ROBERT H. FOUKE

Attorney for the plaintiff, Mount
Tivy Winery, Inc.

[Endorsed]: Filed Nov. 1, 1941. [31]

[Title of District Court and Cause.]

ORDER FOR JUDGMENT

Ordered:

That plaintiff take nothing by its action and that defendants be dismissed with costs.

Counsel for defendants may prepare and submit findings of fact, conclusions of law, and judgment in accordance with opinion filed this day.

Dated: January 10, 1942.

A. F. ST. SURE

United States District Judge.

[Endorsed]: Filed Jan. 10, 1942. [32]

[Title of District Court and Cause.]

OPINION

St. Sure, District Judge:

Plaintiff sues to recover \$15,419.33, with interest, claimed to have been illegally imposed and collected by defendants under the "Liquor Taxing Act of 1934." [33]

The complaint contains two counts. The first states a claim for recovery, if justified by the law and the evidence. The second adopts the allegations of the first, by reference, and adds that section 10(C)¹ of the Liquor Taxing Act of 1934, under the provisions of which the taxes were assessed and collected, violates Article I, section 2, clause 3, and Article I, section 9, clause 4 of the Constitution of the United States of America.

The case was submitted upon a stipulation of facts and briefs of respective parties. There are six other cases in which the stipulated facts are similar, and all seven cases were consolidated for trial. The decision in the instant case is determinative of all. The plaintiffs in the other cases, and the amounts

1. "Upon all wines held by the producer thereof upon January 12, 1934, and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected and paid a floor tax equal to the amount, if any, by which the tax provided for under section 443 of this title exceeds the tax paid upon the grape brandy or wine spirits used in the fortification of such wine." 26 USCA § 451b, 1934 Cumulative Annual Pocket Part.

each seeks to recover, with interest, are as follows:

California Wineries and Distilleries, Inc., a California corporation, No. 20464--R, \$13,449.80;

Fresno Winery Inc., a California corporation formerly known as Elsinore Winery, Inc., a corporation, and Lucerne Winery, Inc., a corporation, No. 20465-L, \$6,602.52;

Santa Lucia Wineries, Inc., a California corporation, No. 20466-R, \$13,918.00;

Charles Dubbs and Samuel Caplan, copartners doing business under the firm name and style of Alta Winery, No. 20467-S, \$7,430.57;

California Growers Wineries, a California corporation, No. 20474-W, \$29,923.55;

St. George Winery, a California corporation, No. 21113-L, \$10,577.23.

The defendants are identical in all of the cases.

[34]

Defendants question the jurisdiction of the court as to the suit against United States. There is some discussion in the briefs as to whether the court takes jurisdiction under 28 USCA §41, subd. (20)² (which

2. "The district courts shall have original jurisdiction as follows: * * * (20) * * * of any suit or proceeding commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected, without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the Internal-

is part of the Tucker Act), or sub. (5).³ It is obvious that the 1921 amendment to subd. (20) extended the jurisdiction of the District Court so as to embrace suits against United States where the claim exceeds \$10,000, if the Collector of Internal Revenue by whom the tax was collected is no longer in office when suit is filed. As that is true in this case, the court takes jurisdiction of the United States, if at all, under subd. (20).

The procedure for suits against the United States under 28 USCA § 41(20) is regulated by §§5 and 6 of the Tucker Act, 28 USCA §§762, 763. Title 28 USCA §763 provides that "plaintiff shall cause a copy of his petition * * * to be served upon the" United States District Attorney "in the District wherein suit is brought, and shall mail a copy [35] of the same, by registered letter, to the Attorney General * * *," and shall file with the Clerk of the court an affidavit of such service. "This procedure must be complied with strictly. *Reid Wrecking Co. v. United States*, D. C. 202 F. 314, and all its re-

Revenue laws even if the claim exceeds \$10,000, if the collector of internal revenue by whom such tax, penalty, or sum was collected is dead or is not in office as collector of internal revenue at the time such suit or proceeding is commenced."

3. "Of all cases arising under any law providing for internal revenue, or from revenue from imports or tonnage, except those cases arising under any law providing revenue from imports, jurisdiction of which has been conferred upon the Court of Customs Appeals."

quirements must be met before the commencement of the action can be effected.” *Bachman, Emmerich & Co. v. U. S.* 21 F. Supp. 682, 684; see also *Reid v. United States*, 211 U. S. 529, 538; *Munro v. United States*, 303 U. S. 36, 40. The requirements for service are jurisdictional.

Here service was made upon the United States Attorney of this District on January 30, 1939. A stipulation filed herein on November 1, 1941 (more than five months after trial) states that the Attorney General was served on February 28, 1939. As the claim which was the basis of this action was rejected on July 29, 1936, both services were made after the expiration of the two-year limitation allowed by 26 USCA §3772(a)(2).⁴

Although this suit was filed on July 28, 1938, (the last day on which it could have been filed under the two-year limitation), plaintiff argues that service as prescribed by 28 USCA §763 is merely procedural and not substantive, and therefore, since the adoption of the Federal Rules of Civil Procedure, effective September 16, 1938, [36] such service is not necessary to commence an action

4. “No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of two years from the date of mailing by registered mail by the Commissioner to the taxpayer of a notice of the disallowance of the part of the claim to which such suit or proceeding relates.”

against the United States, citing Rule 3,⁵ Rule 4(d)(4),⁶ and *United States v. American Surety*, 25 F. Supp. 700, 702. On the question of whether the new Rules apply to the Tucker Act, a careful examination of the law on this subject⁷ shows that

5. "A civil action is commenced by filing a complaint with the court."

6. "* * * Service shall be made as follows: * * * (4) Upon the United States, by delivering a copy of the summons and of the complaint to the United States attorney for the district in which the action is brought or to an assistant United States attorney or clerical employee designated by the United States attorney in a writing filed with the clerk of the court and by sending a copy of the summons and of the complaint by registered mail to the Attorney General of the United States at Washington, District of Columbia, and in any action attacking the validity of an order of an officer or agency of the United States not made a party, by also sending a copy of the summons and of the complaint by registered mail to such officer or agency."

7. *U. S. v. American Surety*, 25 F. Supp. 700, 702; *Sherwood v. U. S.* 112 F. (2d) 587, 590, reversed, *U. S. v. Sherwood*, 312 U. S. 584; *Boerner v. U. S.*, 26 F. Supp. 769. See also *Gallagher v. Carroll*, 27 F. Supp. 568; *Schram v. Koppin*, 35 F. Supp. 313, *Schram v. Costello*, 36 F. Supp. 525; *Schram v. Cudnau*, D. C. E. D. Mich., decided December 26, 1940; *Hackner v. Guaranty Trust Co. of N. Y.*, 117 F. (2d) 95; *Federal Rules Service with Vindex*, Vol. 4, pp. 882-887; "Federal Rules of Civil Procedure and Proceedings of the American Bar Association Institute, Cleveland 1938", pp. 183 and 202-203; "Federal Rules of Civil Procedure, Proceedings of Institutes, Washington and New York, 1938, Published by American Bar Association", pp. 34-35; *New Federal Procedure and the Courts*, by Alex Holsoff, 1940, pp. 16-17.

some courts have held that the Rules prevail over the Tucker Act. However, I am of the opinion that as the Tucker Act is a special statute with special procedure outlined by Congress, the new Rules are inapplicable. *Lynn v. United States*, 110 F. (2d) 586; *United States v. Sherwood*, [37] 312 U. S. 584, 586-7. From the discussion of Rules 3 and 4 before the Judiciary Committee of the House of Representatives, 75th Congress, Third Session, Hearings on the Rules of Civil Procedure and H. R. 8892, March 1-4, 1938, Serial 17, pages 73 ff., it appears that the Committee considered a statute of limitations substantive law and intended that the Rules should govern only where there was no Federal or state statute on the subject. A suit against United States, filed under 28 USCA §763, is not "commenced" until the service mentioned is made. As service in this case was made after the expiration of the two-year period allowed by 26 USCA §3772(a)(2), the right of action against United States ceased, and the subsequent adoption of the new Rules did not revive it.

It is true that in *United States v. Sherwood*, *supra*, the Supreme Court approved dismissal for want of jurisdiction where an individual had been joined in the suit against the United States. However, dismissal of the entire action would not be proper here, because this Court has jurisdiction of the Collector of Internal Revenue under 28 USCA §41(5), which requires no special service on the

United States Attorney of this District and on the United States Attorney General.

I therefore conclude that as necessary service to effect commencement of the action as required by 28 USCA §763 was not made within the two-year period specified in 26 USCA §3772(a)(2), this court has no jurisdiction over defendant United States, but has jurisdiction over the Collector under 28 USCA §41(5). [38]

In three of the companion cases mentioned above, namely, No. 20464-R, No. 20474-W, and No. 21113-L, service as required by the Tucker Act (28 USCA §763) was made within the two year period specified in 26 USCA §3773(a)(2), so that in those cases this court would have jurisdiction of the United States as well as of the Collector of Internal Revenue; but in view of my holding against plaintiff in all cases, the point becomes immaterial.

Plaintiff contends that §10(c) of the Liquor Taxing Act of 1934 violates Art. I, Sec. 2, Cl. 3, and Art. I, Sec. 9, Cl. 4 of the United States Constitution, in that it levies a direct tax without proper apportionment. There is no merit in this contention. In *Pennsylvania v. Fix*, 9 F. Supp. 272, 275-276, (affirmed in 79 F. (2d) 520, certiorari denied, 297 U. S. 704), the court held that the tax levied by §10(c) is an excise tax, and as such, constitutional.

In one of its briefs plaintiff attempts to make another constitutional point, stating:

“Imposition of the tax upon merely one part

of a class of persons deprives such persons of the 'equal protection of the laws' under the due process clause of the United States Constitution, hence the tax is unconstitutional for this, as well as other reasons noted. Fifth Amendment to the Constitution of the United States, (Article V)."

This loose language, without explanation or authority, is plaintiff's only reference to the Fifth Amendment. The constitutionality of a statute cannot be raised for the first time in argument. It must be properly pleaded and thereafter adequately argued. *Kewanee Oil & Gas Co. v. Mosshamer*, 58 F. (2d) 711, 712; *White Cleaners & Dyers v. Hughes*, 7 F. Supp. 1017, 1023; *Taylor v. Dunbar*, 298 F. [39] 936, 939. A court should proceed with reluctance to set aside legislation as unconstitutional on grounds not properly presented. *McGoldrick v. Compagnie Generale*, 309 U. S. 430, 434. Moreover, "There is strong presumption in favor of the constitutionality and validity of an act of Congress." *Jacobs v. Peavy-Wilson Lbr. Co.*, 33 F. Supp. 206, 212, and cases cited. The mere fact of enactment of a statute raises a presumption of constitutionality, and the burden of proving otherwise is on the party so asserting. *Kewanee Oil & Gas Co. v. Mosshamer*, 58 F. (2d) 711, 712. Plaintiff has failed to sustain that burden. The additional point was probably thrown in, hit or miss, but has no application whatever to the pertinent issue of the levy and collection of an excise tax on liquor, the validity of

which is settled by the decision in *Pennsylvania v. Fox*, *supra*. For a full discussion of the subject see *Patton v. Brady*, 184 U. S. 608.

Upon the merits, plaintiff contends that it is not liable for the tax because on the effective date of the taxing act, January 12, 1934, the liquor was "held" by the Bank and not by plaintiff.

Plaintiff is a large winery, engaged in the manufacture and production of wines "intended for sale or for use in the manufacture or production of any article intended for sale", as set forth in Section 10(c) hereinabove mentioned. In the latter part of 1933 plaintiff placed the liquor in question in a bonded warehouse, taking four negotiable warehouse receipts, which were delivered to Bank of America under "a collateral pledge agreement," as security for a loan to plaintiff. [40]

"Under the Uniform Warehouse Receipts Act, the warehouseman is ordinarily bound to deliver the goods upon a demand made * * * by a holder of a receipt for the goods * * * if such demand is accompanied with an offer to satisfy the warehouseman's lien, an offer to surrender the receipts if negotiable and a willingness to sign an acknowledgment of delivery." 25 Cal. Jur. p. 955, Section 12; Uniform Warehouse Receipts Act, Section 8. Here the Bank, the holder of the receipt, could not properly demand plaintiff's wine from the warehouseman except under certain conditions set forth in the "collateral pledge agreement" between plaintiff and the Bank. As these conditions never matured,

the Bank never acquired the right to negotiate the receipts. The "collateral pledge agreement" refers to the Bank as "pledgee or trustee", and provides that in case of sale the surplus was to be "subject to the order of" plaintiff.

The warehouse receipt is only *prima facie* evidence of ownership. *Akron Cereal Co. v. First National Bank*, 3 Cal. App. 198, 201-2. The title to the liquor was in plaintiff, the pledgor. The Bank never had any more than a pledgee's rights under the terms of the collateral agreement. As contended by defendants, the storing of the wine in a bonded warehouse and the issuing of warehouse receipts therefor was a transaction for the accommodation of plaintiff and created only a debtor-creditor relationship between plaintiff and the Bank, and did not in any way relieve plaintiff of its liability to pay the tax. The word "held" implies ownership, *McFeely v. Commissioner*, 296 U. S. 102, 107; but does not always imply possession, *Ogle v. Helvering*, 77 F. (2d) 338, 339; *Commissioner v. Nevius*, 76 F. (2d) 109. [41]

Plaintiff's argument that it could not set up its own title "to defeat the pledge of the property by the warehouse to the Bank" is untenable, because if either the Bank or the warehouseman should refuse to deliver the liquor to plaintiff after plaintiff had carried out its contractual obligations, plaintiff could file suit to assert its title and recover its pledged property. 3008 California Civil Code; *Bell v. Bank of California*, 153 Cal. 234,

238; Brittan v. Oakland Bank, 124 Cal. 282; Hunsaker v. Sturgis, 29 Cal. 142, 145. Plaintiff at all times asserted ownership of the liquor, as shown by its verified inventory and return to the Collector of Internal Revenue.

I conclude that the liquor in question was "held" by plaintiff within the meaning of Section 10(c) on the effective date thereof.

Judgment will go to defendants with costs.

* * * * *

January 10, 1942.

[Endorsed]: Filed Jan. 10, 1942. [42]

[Title of District Court and Cause.]

ORDER ENLARGING TIME TO SERVE AND
LODGE PROPOSED FINDINGS OF FACT
AND CONCLUSIONS OF LAW

Upon motion of the United States Attorney and good cause appearing therefor,

It Is Hereby Ordered that the defendants John V. Lewis and the United States of America shall have to and including Friday, February 6, 1942 within which to serve and lodge proposed Findings of Fact and Conclusions of Law. By previous order time has been enlarged seven days.

A. F. St. SURE

United States District Judge.

Dated: January 23, 1942.

[Endorsed]: Filed Jan. 23, 1942. [43]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly for trial in the above entitled Court, the plaintiff Mount Tivy Winery, Inc., appearing by its Attorney Robert H. Fouke, Esq., and the defendants John V. Lewis and the United States of America appearing and being represented by Frank J. Hennessy, United States Attorney and W. P. Mathewson, Assistant United States Attorney, and the cause having been submitted upon a stipulation of facts and the parties having waived trial by jury, the cause was duly argued by counsel both orally and upon written briefs sub- [44] sequently filed, and the Court now being fully advised in the premises finds the following:

FINDINGS OF FACT

I.

This is an action brought against a former Collector of Internal Revenue by virtue of the provisions of Section 41, sub-division 5, Title 28, United States Code and against the United States of America under the provisions of sub-division 20 of Section 41 of Title 28, United States Code to recover \$15,419.33 in taxes and interest alleged to have been erroneously and illegally assessed and collected.

II.

The plaintiff, a California corporation with its principal place of business in the City of Fresno, County of Fresno, State of California, in the Northern Division of the Southern District of California, engaged in the manufacture, production and sale of wine intended for sale or for use in the manufacture or production of articles intended for sale, in Bonded Winery No. 3620, located at LacJac, Fresno County, State of California, within the First California District, Department of Internal Revenue, Treasury Department, United States of America, and in the Northern Division of the Southern District of California.

III.

The defendant John V. Lewis, a resident of the Southern Division of the Northern District of California, was the duly appointed, qualified and acting United States Collector of Internal Revenue for the First California District at the time of the assessment and collection of the taxes. Prior to the filing of the Complaint the defendant John V. Lewis resigned as Collector of Internal Revenue for the First California Dis- [45] trict.

IV.

On November 13, 1933 the plaintiff and the Fidelity Warehouse Corporation, a California corporation, executed a Field Warehouse Storage Agreement which provided among other things that the Fidelity Warehouse Corporation should furnish the

plaintiff all field warehouse services necessary to the plaintiff's business and that the plaintiff should employ the Fidelity Warehouse Corporation for all field warehouse services required by the plaintiff and further, that the plaintiff would furnish warehouse premises owned or controlled by the plaintiff in which field warehousing was to be conducted. Under the agreement the Fidelity Warehouse Corporation agreed among other things for the consideration therein expressed and subject to the terms and conditions therein contained (1) to maintain a public warehouse in and upon premises leased by the plaintiff to the corporation; (2) to furnish to the plaintiff all field warehouse services necessary to the plaintiff's business; (3) to place a bonded agent and/or bonded watchman in charge of the warehouse and leased premises; and (4) to issue field warehouse receipts upon the property which the plaintiff might store therein; the agreement also provided, however, (a) that the Fidelity Warehouse Corporation should be free from all liability for taxes, assessments, charges or penalties levied, assessed or imposed by a Federal, State, County or Municipal Government or by any other quasi-public or Governmental agency upon or in respect of the wines warehoused under the terms of the agreement; (b) that the plaintiff agreed to render all reports required of the plaintiff or the corporation or of either of them in respect to the commodities warehoused by any and all Governmental agencies; and (c) that at the option of the Fidelity

Warehouse Corporation it could pay [46] all taxes, assessments, charges or penalties and could service, blend, fortify, rectify, handle and care for the warehoused wines and could render all reports at the expense of the plaintiffs in the event the plaintiff failed to do so as agreed in the agreement.

V.

On the same date, November 13, 1933 the plaintiff, pursuant to the provisions of the Field Warehouse Storage Agreement and as authorized by Treasury Decision No. 19, executed in writing, a Field Warehouse Lease, which leased to the Fidelity Warehouse Corporation a portion of a building and all containers therein for use as a warehouse. The building so leased was adjacent to the same premises as plaintiff's Bonded Winery No. 3620, bore the same postoffice box number and was contiguous with and adjoining the structures of plaintiff's Bonded Winery No. 3620.

VI.

On November 25, 1933, as the result of an application made by it on November 20, 1933, under the authority of and pursuant to the laws of the State of California and of the United States and of the regulations issued pursuant thereto and particularly Treasury Decision No. 19 and General Circular No. 141 approved September 16, 1933 which read as follows:

“Bureau of Industrial Alcohol”

T. D. 19

September 16, 1933.

Section 704 of Regulations 2 and Paragraph
9 of Regulations 7, amended.

Treasury Department,
Office of Commissioner of Industrial Alcohol.
To Supervisors of Permits
and Others Concerned:

1. Section 704 of Regulations 2 is amended
to read [47] as follows:

Sec. 704. Bonded storerooms. Hereafter no permit will be issued for the establishment of a bonded storeroom for wines unless the proprietor is also duly qualified as the proprietor of a bonded winery; provided, however, the Commissioner may authorize the establishment of public bonded storerooms, known as field warehouses, by responsible warehouse companies, other than winemakers, for the storage of wine for credit purposes when in his judgment such is warranted; Provided that

(1) No person, firm or corporation advancing credit upon the security of such wine or upon the security of warehouse receipts or other instruments issued on account thereof shall have power or authority to possess or use the said wine in any manner or to dispose of it upon foreclosure or otherwise except to a bona

fide holder of a permit entitling the permittee to acquire or otherwise deal with the said wine;

(2) Warehouse receipts or other instruments issued on account of such wine shall not be transferable except to a bona-fide holder of a permit entitling the permittee to acquire or otherwise deal with the wine on account of which the said warehouse receipts or other instruments were issued;

(3) Warehouse receipts or other instruments issued on account of such wine shall show on their face the restrictions contained in numbered paragraphs (1) and (2) hereof.

Proprietors of bonded wine storerooms heretofore established, who are not also producers of wine, will, when all stocks of wine which they now possess have been exhausted, surrender their permits to the supervisor.

2. Paragraph 9 of Regulations 7 is amended to read as follows:

Para. 9. Bonded storerooms may be established only by proprietors of bonded wineries: Provided, however, pursuant to the provisions of Regulations 2 the Commissioner may authorize the establishment of public bonded storerooms, known as field warehouses, by responsible warehouse companies, other than winemakers, for the storage of wines for credit purposes, when in his judgment such is warranted.

J. N. DORAN,
Commissioner of Industrial Alcohol.

Mount Tivy Winery

Approved: September 16, 1933.

J. EDGAR HOOVER,

Director, Division of Investigation,
Department of Justice.

THOMAS HEWES,

Acting Secretary of the Treasury.

HOMER S. CUMMINGS,

Attorney General. [48]

“Treasury Department
Bureau of Industrial Alcohol

General Circulars, No. 141.

September 16, 1933.

Subject: Opinion of the Attorney General concerning the interpretation of the National Prohibition Act with relation to the storage of wine in public warehouse and the issuance of receipts therefor to banks, etc., for credit purposes.

To Supervisors of Permits
and Others Concerned:

In connection with T. D. No. 19, approved September 16, 1933, there is quoted below an opinion of the Honorable Homer S. Cummings, Attorney General, rendered under date of September 13, 1933, concerning the interpretation of the National Prohibition Act with relation to the storage of wine in public warehouses and the issuance of receipts therefor to banks, etc., for credit purposes.

‘The Honorable

The Secretary of the Treasury.

‘Sir:

‘I have the honor to acknowledge the receipt of your letter of September 11, 1933, from which it appears that the suggestion has been made to your Department that Section 704 of Regulations 2 and Paragraph 9 of Regulations 7, of the Bureau of Industrial Alcohol, be amended so as to permit the Commissioner of Industrial Alcohol to authorize the establishment of public bonded storerooms by responsible warehouse companies, other than wine-makers, for the storage of wines for credit purposes. You state that an essential part of such credit purposes would be some arrangement, made through the issuance of warehouse receipts or otherwise, whereby a lending bank or other institution could acquire title to the warehoused wine for its protection in the event the debtor defaulted in his obligation; and that the proposed arrangement further contemplates that the bank or other lender acquiring title to the warehoused wines would be able to dispose of such wines only to persons lawfully entitled to purchase them.

‘You request my opinion as to whether such an arrangement could lawfully be entered into under the National Prohibition Act and its amendments, or whether it would be precluded by 32 Opinions of the Attorney General 392.

‘In the opinion referred to the question presented was whether the authority of the Commissioner of Internal Revenue (now the Commissioner of Industrial Alcohol) to issue permits for the sale of wholesale quantities of intoxicating liquor was limited to manufacturers and wholesale druggists. The question was answered in the affirmative and it was held that liquor for nonbeverage purposes could be dealt in only by manufacturers and wholesale and retail druggists. See also *Small Grain Distilling & Drug Co. v. Hamilton*, 276 Fed. 544. [49] The aforesaid opinion dealt with the sale of liquor by persons regularly engaged in the business of selling liquor. Under the proposed plan now before me the bank or other lender is not to deal in liquor as such. It is an arrangement to create credit facilities for processing the grape crop. The arrangement contemplates the borrowing of money from a bank, governmental loaning agency or other institution by wine manufacturers for the purpose of purchasing grapes for processing. As security for the loan wines are to be deposited pursuant to permit in bonded winery warehouses, or in public banded storerooms, known as field warehouses under the Uniform Warehouse Receipt Acts, operated by responsible warehouse companies and to be established under the above amended regulations. For the wine so deposited ware-

house receipts are to be issued to the bank or other institution covering the warehoused wine for the protection of the lending institution. The warehouse receipts are to show on their face or by proper endorsement that the bank or other lender shall have no power or authority to possess or use the wine in any manner, or to dispose of it or to transfer the warehouse receipts, upon foreclosure or otherwise, except to bona fide permit holders.

‘It will thus be seen that under the proposed arrangement the bank would not have physical possession of the wine and would hold title only for credit purposes. The wine is to be warehoused in a public bonded or winery warehouse pursuant to permit and is not to go into consumption or trade except upon foreclosure, and then only upon the presentation of a proper permit by a purchaser permittee.

‘In my opinion such an arrangement so circumscribed as to prevent any possible beverage use of the wine would not be contrary to the purpose and intent of the National Prohibition Act, nor be precluded by the opinion referred to above.

Respectfully,

(Signed) HOMER S. CUMMINGS,

Attorney General.’

J. M. DORAN,

Commissioner.’”

the Supervisor of Permits issued a permit to the Fidelity Warehouse Corporation to establish and operate a public bonded storeroom in the leased premises to be known as Public Bonded Storeroom No. 3728.

VII.

The leased premises were in the lawful possession and under the control of the Fidelity Warehouse Corporation under the terms and conditions of the lease. Signs were placed [50] over and outside the entrances and inside the leased premises to the effect that the leased premises were registered Public Bonded Storeroom No. 3728 of the Fidelity Warehouse Corporation. Locks were placed upon all entrances to the leased premises by the Fidelity Warehouse Corporation and the key to each of the locks was in the possession and was retained by the agent of the Fidelity Warehouse Corporation in charge of the leased premises. The Fidelity Warehouse Corporation employed a bonded agent to whom detailed printed instructions were given as to his duties. The salary of this agent was paid by the Fidelity Warehouse Corporation. The plaintiff was not permitted access to the leased premises except through the bonded agent of the Fidelity Warehouse Corporation in accordance with the terms of the agreement and then only under the observation and supervision of the bonded agent who kept it locked at all times that he was not personally there and the bonded

agent received and delivered all merchandise at the leased premises.

VIII.

The Field Warehouse Storage Agreement and the Field Warehouse Lease were executed prior to the passage of Section 10 (c) of the Liquor Taxing Act of 1934 and at the time of the execution of these agreements the Fidelity Warehouse Corporation and the plaintiff did not know that Section 10 (c) of the Liquor Taxing Act of 1934 was contemplated or would be enacted into law and neither before nor at the time of the execution of these agreements did either or both of these parties negotiate, contemplate or execute the agreements in order to avoid or evade the provisions of Section 10 (c) of the Liquor Taxing Act of 1934.

IX.

During the months of November and December, 1933 and [51] before January 12, 1934 plaintiff removed 484,000 gallons of fortified wine from Bonded Winery No. 3620 and stored it in Public Bonded Storeroom No. 3728 and in writing requested the Fidelity Warehouse Corporation to issue four original wine warehouse receipts negotiable in form, for a total of 484,000 gallons of wine to the Bank of America National Trust & Savings Association, Fresno Branch, or order (hereinafter referred to as "the Bank") as follows: One for 211,000 gallons dated November 29, 1933, numbered 01304; the second for 123,000 gallons dated Decem-

ber 4, 1933, numbered 01307; the third for 119,000 gallons dated December 22, 1933, numbered 01312; and the fourth for 31,000 gallons dated January 6, 1934, numbered 01316; which receipts were issued and executed in the name of and were delivered at the request of the plaintiff on those dates to the Bank by the Fidelity Warehouse Corporation.

X.

The warehouse receipts with the exception of the number, date and wine described therein read as follows:

“Original

No. 01304

Negotiable Warehouse Receipt

Issued By

Fidelity Warehouse Corporation

Main Office, 351 California St.

San Francisco, California.

November 29, 1933.

This Is to Certify, That this Corporation has received for storage in its warehouse at Lac Jac, California from Mount Tivy Winery, Inc. deliverable to Bank of America National Trust & Savings Association, Fresno Branch, or order, in apparent good order, except as noted hereon (contents, condition and quality unknown) the following described property, subject to all the terms and conditions contained herein and payment of all storage and other charges.

Tank	Style	Said to Contain	Said to Contain
*	*	*	*

‘This Fidelity Warehouse Company warehouse receipt is issued pursuant to permit No. P-18, issued by [52] the Bureau of Industrial Alcohol, United States Treasury Department, in accordance with section 704 of Regulations 2 and Paragraph 9 of Regulations 7, as amended, which authorized the issuance of this warehouse receipt.’

“All goods are stored and handled subject to the rules, regulations, rates and charges as set forth in that certain lease agreement existing between the above named depositor and Fidelity Warehouse Corporation; warehouseman hereby claims lien on above described goods for storage and other charges as set out in the said lease agreement.

Rates do not include fire or other insurance. Warehouseman does not arrange for insurance unless instructed in writing to do so. The location of merchandise as shown on this warehouse receipt is not given for insurance purposes, and all liability is disclaimed for error or insufficiency in the location, if such location is used.

Warehouseman is not responsible for loss or damage caused by fire (from any cause), frost or change of weather, riots, strikes, insurrections, or from inherent or perishable qualities of the merchandise, or other causes beyond his control; and is not responsible for loss or damage caused by leakage, pilferage, ratage, theft,

vermin or water, unless such loss or damage be caused by the failure of the warehouseman to exercise ordinary care and diligence.

These goods will be delivered upon surrender of this receipt, properly endorsed, and the payment of all charges and liabilities due the undersigned warehouseman.

The Wine Covered by This Warehouse Receipt Cannot be Possessed, or Used in any Manner or Disposed of or Transferred Except to a Bona Fide Permittee of the Bureau of Industrial Alcohol.

FIDELITY WAREHOUSE
CORPORATION,

By
Assistant Secretary."

XI.

The 484,000 gallons of fortified wine deposited with the Fidelity Warehouse Corporation evidenced by the warehouse receipts and stored in the warehouse on January 12, 1934 had been produced by the plaintiff at its Bonded Winery No. 3620 prior to January 11, 1934 and contained 147,927.08 proof gallons of brandy previously withdrawn from a distillery and previously used in the fortification of the wine produced by the plaintiff. Prior to January 11, 1934 and at the time of the withdrawal and use of the brandy in fortifying the wine there had been assessed against the plaintiff a tax of [53] 10 cents per proof gallon as required by the Internal Revenue law of 1918 as amended.

XII.

On January 12, 1934 the plaintiff had in its Bonded Winery No. 3620, 220,297.34 gallons of fortified wine. This wine had likewise been produced by the plaintiff in its winery and contained 61,863.88 proof gallons of brandy which had also previously been withdrawn from a distillery for the fortification of the wine produced by the plaintiff and upon this brandy plaintiff had been assessed a tax at the rate of 10 cents per proof gallon as required by the Internal Revenue law of 1918 as amended. The plaintiff made no claim for the abatement or refund of the tax assessed by the Collector of Internal Revenue on this wine and the plaintiff does not seek to recover that tax in this action.

XIII.

Upon receipt of the wine from the plaintiff the warehouse company placed it in storage tanks located upon the leased premises and caused to be placed upon the tanks in which the wine was stored, stock cards showing that the wine was warehoused to the Bank, the description of the wine, the date of the warehousing, the negotiable warehouse receipt number issued against the wine and the quantity and quality of the wine stored therein.

XIV.

In accordance with the provisions of the Field Warehouse Storage Agreement and in accordance with an understanding between the plaintiff and

the Fidelity Warehouse Corporation the plaintiff was from time to time permitted to have access to the bonded storeroom for the purpose of servicing and caring for the wine during the period the wine was stored in the bonded storeroom. [54]

XV.

All of the wine except as otherwise specified herein was in the physical possession and under the physical control of the Fidelity Warehouse Corporation and was held by it as a bonded warehouseman in its Public Bonded Storeroom No. 3728 under the laws of the State of California, and United States of America, and the rules and regulations of the Treasury Department including T.D.#19 and the agreements between it and the plaintiff, the plaintiff and the Bank and it and the Bank. Prior to January 12, 1934 and prior to the actual issuance of the warehouse receipts the Bank from time to time extended unsecured bank credits to the plaintiff. As wine was produced and delivered by the plaintiff to the warehouse company the warehouse company issued the warehouse receipts described above covering the wine. These warehouse receipts were delivered to and were received by the Bank. At the request of the Bank, the plaintiff executed several promissory notes payable to the Bank and executed a collateral agreement with the Bank which read as follows:

“In Consideration of all financial accommodations given, or to be given, or continued, to the undersigned Mount Tivy Winery, Inc., a

California corporation, by Bank of America National Trust & Savings Association, (hereinafter called the Bank), and as collateral security for the payment of any indebtedness, obligation or liability of the undersigned to said Bank now or hereafter existing, matured or to mature, absolute or contingent, and wherever payable, including such as may arise from endorsements, guarantees, acceptances or paper discounted by said Bank, or held by said Bank or taken as security for any loans or advances of any sort whatever, and including overdrafts and indebtedness of the undersigned to said Bank on account of collections or paper received for collection, and the interest which may accrue on any thereof and expenses which may be incurred by the Bank, in the collection of any thereof including attorney fees, the undersigned does hereby assign, transfer to, and deposit with the said Bank, all property this day delivered by the undersigned to the Bank, or which may now be held by the Bank, or which may hereafter be delivered by the undersigned to the Bank during the existence of this agreement, and of which property the undersigned is the owner, the same being stored, deposited and cared for at [55] the risk and expense of the undersigned. The power of sale and other powers hereinafter given shall apply to all collaterals of any kind, nature or description, including all moneys, negotiable

instruments, bonds, stock, commercial paper, credits, choses in action, claims or demands of every kind, nature and description at any time during the existence of this agreement in possession or control of said Bank or any of its agents or correspondents, or in transit to it by mail or carrier, belonging to, for the account of, or subject to the order of the undersigned.

Full power is hereby given to said Bank to collect any and all amounts which may become due upon any of the said securities which may be so deposited with it, and to apply the amounts so collected to the indebtedness or any part of said indebtedness, and to endorse on behalf of and in the name of the undersigned any and all of said collaterals and securities and to give receipts therefor in the name of the undersigned for any amounts which it may receive thereon, or upon any of said collaterals, but said Bank shall be under no obligation to collect any such sums or amounts.

Said Bank is hereby authorized to cause to be transferred to its own name, or to the name of any other person or corporation, as pledgee or trustee or otherwise, any certificates of stock, warehouse receipt or other instruments which are now or may hereafter be deposited with it by the undersigned as security as aforesaid; and such transferee may exercise all of the rights and privileges in connection with

said securities to which said transferee may be entitled by virtue of being the holder of record thereof, in addition to the rights or privileges otherwise granted to said Bank hereunder. But said Bank or said transferee shall not be obliged to exercise any of said rights or privileges.

If, with the consent of said Bank, the undersigned shall substitute or exchange other securities in place of the collaterals above specified, then all of the rights or privileges of said Bank, and the obligation on the part of the undersigned shall be forthwith applicable to said substituted or exchanged securities, to same extent as the property originally pledged or held as collateral as aforesaid hereunder.

In the event either of a failure in business or insolvency or bankruptcy or a general assignment by the undersigned, or a failure to pay the principal or interest on any indebtedness or liability according to the terms of the contract under which the same was incurred, then all the liabilities of the undersigned to the Bank shall, at the option of the Bank, become immediately due and payable, notwithstanding any credit or time allowed to the undersigned by the instrument evidencing any of said liabilities; and in any such event, the undersigned does hereby constitute and appoint said Bank, its successors or assigns, the attorney in fact of the undersigned, irrevocable, with full pow-

ers of substitution and revocation, and does hereby authorize, empower and instruct the said attorney, or assigns to sell without any previous demand, or demand of performance, upon the undersigned, and with or without notice to the undersigned, at its option, the whole or any part of said securities, either at public or private [56] sale or at Broker's Board, at its discretion, and without any advertisement or notice of such sale, and to deliver the same to the purchaser or purchasers thereof, the Bank being at liberty to become the purchaser if the sale is public or private or at Broker's Board and to hold any and all property so purchased discharged of any rights of redemption whatever. The undersigned hereby expressly waives the provisions of Section 3006 of the Civil Code and all rights thereunder. After deducting all legal and other costs, expenses and charges of every kind incurred in the collection, sale and delivery, or in the preservation, of said property or any part thereof, said Bank shall apply the residue of the proceeds of the sale to the payment of all of the aforesaid indebtedness, to-wit: The indebtedness and liabilities and every part thereof, payment whereof is hereby intended to be secured, and the interest thereon; and should there be any surplus of said proceeds after the payment of said notes, expenses, charges and said indebtedness and liabilities, and every part thereof, it shall be subject to the order of the undersigned.

In like manner the undersigned does agree to pay on demand in lawful money of the United States of America to the said Bank whatever balance may be due after said securities have been sold and application of the proceeds as above provided has been made.

In the case of the deterioration of any of the above mentioned securities in whole or in part, or any fall or depreciation in the market value of the same, the undersigned does hereby authorize said Bank, at its option, to sell and dispose of said securities, or any part hereof, as above provided, at any time before or after the maturity or maturities of said indebtedness, obligation or liability of the undersigned to said Bank within the contemplation hereof, or any of them, in which event the undersigned does specifically waive any notice whatsoever of such depreciation or fall in market value, any and all demand upon the undersigned to redeem or otherwise protect such security, and any and all notice of intention on the part of said Bank to sell said securities, or any of them, the purport hereof being that the undersigned does agree and authorize said Bank to sell and dispose of said securities, or any of them, in the event of such depreciation or fall in market value, without any notice to or demand upon the undersigned and without any notice or advertisement whatsoever and without reference to the maturity or maturities of any of the said

indebtedness, obligations or liabilities secured hereby; and the undersigned does hereby give and grant unto said Bank the same rights, privileges and powers regarding said securities and their sale as are hereinbefore given by the undersigned in the event of other default hereunder or by the terms of the instrument evidencing the same.

It Is Further Agreed that these presents constitute a continuing agreement applying to any and all future, as well as to existing transactions, between the undersigned and said Bank, and that the powers of sale, and other powers, rights and privileges hereinabove given, are to apply to and bind the heirs, executors, administrators, successors and assigns of the respective parties hereto.

In Witness Whereof, the said Corporation has caused this collateral pledge agreement to be executed under its Corporate Name and Seal by its officers thereunto duly authorized by resolution of its Board of Directors. [57] at Fresno, California, this 12th day of December, A.D. 1933.

(Seal) MOUNT TIVY WINERY, INC.

(Seal)

By (signed) L. POWERS, Jr.

President.

(Seal)

By (signed) M. T. McELIGOTT,
Secretary."

XVI.

The 484,000 gallons of fortified wine thus delivered to the warehouse company for storage in Public Bonded Storeroom No. 3728 by the plaintiff prior to January 11, 1934 was produced and intended for sale and was subsequently sold in the following manner:

XVII.

The plaintiff secured a prospective purchaser for the wine and notified the Bank of the proposed terms of the sale. In the event the purchaser and the terms of sale were satisfactory to the Bank the sale was consummated with the approval of the Bank upon a cash or credit basis. As a part of the same general sales transaction the Bank would then execute and deliver to the Fidelity Warehouse Corporation an order for warehouse release covering the wine sold to the purchaser. The warehouse receipts were then either delivered to the warehouse company for cancellation or for endorsement thereon of the amount of the wine sold or for the issuance of a new warehouse receipt, negotiable in form, in the name of and to the order of the Bank for the remaining unsold quantity of wine covered by the warehouse receipt and the redelivery to the Bank of the cancelled, endorsed or new receipt or the Bank would deliver both the order for warehouse release and the warehouse receipt to the purchaser or the warehouse company [58] subject to the purchaser's further order or endorsement. Subject to the order of the pur-

chaser wine sold to it was thereafter prepared for shipment to the purchaser or its order on the warehouse premises by the plaintiff and the warehouse corporation made an entry on Form 702, a report filed monthly with the defendant by the warehouse company, indicating the release of the wine to the plaintiff and the wine was received by the plaintiff for the purposes mentioned for the account of the purchaser and subject to the order of the purchaser.

XVIII.

The receipts were in the possession and control of the Bank at all times except when surrendered to the warehouse company for the release of wine all of which was subsequently released upon the order of the Bank. The receipts were at all times in the name of the Bank and were never endorsed or negotiated by it.

XIX.

Prior to January 12, 1934 the plaintiff had not defaulted upon its notes nor had any of the other conditions set forth in the collateral pledge agreement under which the Bank could properly demand the wine from the warehouseman matured nor had the Bank negotiated any of the warehouse receipts nor had it disposed of them or of the wine under any of the powers conferred upon it by the collateral pledge agreement.

XX.

The 484,000 gallons of wine so removed and

stored was the first wine to be stored in Public Bonded Storeroom No. 3728 and remained the only wine so removed and stored by the plaintiff or anyone else up to and including January 12, 1934. [59]

XXI.

The Bank did not pay personal property taxes or any taxes imposed by the Liquor Taxing Act of 1934 upon the wine covered by the warehouse receipts. All taxes on the wine were paid by the plaintiff in accordance with and pursuant to the agreement with the warehouse corporation.

XXII.

In accordance with and pursuant to instructions from the Commissioner of Internal Revenue the defendant John V. Lewis for and on behalf of the United States of America caused to be delivered to the plaintiff a mimeographed circular dated January 15, 1934, entitled 'Field Tax on Distilled Spirits, Wine, Cordials, etc.' which provided:

"Copy
page 1.

Treasury Department
Office of the Collector of Internal Revenue
San Francisco

Floor Taxes on Distilled Spirits, Wines,
Cordials, Etc.

January 15, 1934.

To Whom It May Concern:

The 'Liquor Taxing Act of 1934' became a law containing provisions for floor taxes on

Distilled Spirits, Wines, Cordials, Etc., which are held and intended for sale or for use in the manufacture or production of any article intended for sale on the effective date of the Act—January 12, 1934, at the commencement of business. A supply of return forms 758 will be forwarded to you as soon as received from the printer. Your attention is directed, therefore, to the following steps, which should be taken with the greatest possible dispatch:

As time will not permit printing and distribution of inventory blanks for the purpose, each such taxpayer should immediately prepare sheets of paper which should not be larger than $10\frac{1}{2}$ x 16 inches but as many sheets as necessary may be used. Each kind of spirits, wines, etc., should be listed separately, and in the case of distillers' or wine-makers' original packages or cases of bottled-in-bond spirits, the serial numbers of the packages or cases and name of distiller or winemaker should be shown; also the wine gallons, proof gallons of distilled spirits, alcohol and rectified spirits should be given, and the wines should be separated by alcoholic content, i.e., the quantity in wine gallons containing 14 per cent alcohol or less, quantity containing [60] more than 14 per cent and not more than 21 per cent alcohol, quantity containing more than 21 per cent and not more than 24 per cent alcohol, and quantity containing more than 24 per cent alcohol,

should be stated. Carbonated wines, cordials and similar compounds containing more than 24 per cent alcohol should be listed separately, giving the quantity of each kind in wine gallons. The name of the rectifier or bottler or rectified or commercially bottled spirits should be given, together with the wine gallons, proof and proof gallons.

Special care must be taken to also enter on a separate list all goods not on premises of the taxpayer but held by the taxpayer and stored elsewhere, or consigned direct to him and in transit on the date the Act takes effect, giving the name of the consignor and any goods consigned by the party making the inventory to other persons where the title has not been transferred to the consignee on the date the Act becomes effective, giving the name of the consignee.

As soon as the returns, Form 758, are received, fill in the heading on page 1 for each distiller, proprietor of industrial alcohol plant, bonded warehouse, tax-free warehouse or agency, winery, bonded winery storeroom, wholesale liquor dealer, retail liquor dealer, rectifying plant, and manufacturer having alcohol or other distilled spirits or wines on hand for use in the manufacture or production of other articles.

The returns on Form 758 are required to be made in triplicate and the original and dupli-

cate copies filed within 30 days after the effective date of the Act (I.e. on or before February 10, 1934) a copy of the inventory to be attached to each copy of Form 758.

The tax shown to be due must be paid within 30 days after the effective date of the Act, except that the time for payment of this tax may be extended to a date not exceeding seven months after the effective date of the Act, upon the filing of a bond for payment in such form and amount and with such sureties as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury may prescribe.

The following schedule shows the old rate together with the new rate of tax and the increased difference.

Wine	Old Rate	New Rate	Increase
Not more than 14% alcohol.....	4c	10c	6c per gal.
More than 14% and not exceeding 21%...	10c	20c	10c “
More than 21% and not exceeding 24%...	25c	40c	15c “
More than 24% of alcohol by volume classed as Distilled Spirits at \$2.00 per proof gallon.			
Sparkling Wines and Champagne	Old Rate	New Rate	
Each half pint or fraction thereof.....	12c	5c	[61]
Artificially Carbonated Wines	Old Rate	New Rate	
Each half pint or fraction thereof.....	6c	2½c	
Distilled Spirits	Old Rate	New Rate	Increase
	1.10	2.00	.90

On each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon.

The above rates are subject to official confirmation from Washington.

Inventory returns should be mailed to the Collector of Internal Revenue, Room 114, Custom House, San Francisco, California.

(signed) RICHARD NICKELL,
Deputy Collector in Charge"

XXIII.

The plaintiff on February 6, 1934, pursuant thereto and in the belief that a tax was due the United States of America and pursuant to the further belief that it was legally required so to do returned to the defendant John V. Lewis an inventory and return on Form 756, a form prepared and supplied by the defendants to the plaintiff on which form the plaintiff inventoried and returned the fortified wine and the brandy contained therein in the possession of it as the producer thereof and held by it for sale in the use or manufacture or production of any article intended for sale on January 14, 1934.

XXIV.

Form 756 as returned by the plaintiff read as follows: [62]

Form 756 Treasury Department

Internal Revenue Service

Name—Mount Tivy Winery, Inc.

District—11th Permissive

Location of Bonded Premises—Lac Jac, Calif.

Bonded Winery No. 3620

INVENTORY AND RETURN OF FORTIFIED WINES
AND BRANDY CONTAINED THEREIN IN THE POS-
SESSION OF THE PRODUCER AND HELD FOR
SALE OR USE IN THE MANUFACTURE OR PRO-
DUCTION OF ANY ARTICLE INTENDED FOR SALE
ON JANUARY 12, 1934.

Kind of Wine	Wine Gallons	Date of Fortification	Per Cent of Alcohol in Wine After Forti- fication	Per Cent of Brandy in Fortified Wine	Proof Gallons of Brandy in the Wine
Muscat	17,036.38	10/30/33	19.20	11.65	3,983.03
Muscat	17,020.16	10/31/33	19.00	15.42	5,247.35
Port	20,448.06	11/1/33	19.90	14.80	6,052.50
Muscat	13,146.87	11/3/33	18.20	18.65	4,904.32
Port	23,631.95	11/4/33	18.10	19.70	9,311.04
Port	21,859.29	11/6/33	20.30	21.41	11,359.14
Port	27,520.45	11/9/33	21.70	18.91	10,406.51
Port	25,485.98	11/13/33	21.10	14.82	7,554.27
Muscat	26,798.57	11/14/33	21.70	19.42	10,400.45
Port	27,456.50	11/16/33	22.60	22.48	11,247.53
Port	25,958.85	11/17/33	21.50	17.38	9,025.15
Muscat	26,244.33	11/19/33	21.40	16.73	8,783.59
Port	26,052.89	11/22/33	21.30	16.30	8,495.84
Sherry	26,580.27	11/23/33	21.10	12.13	6,447.36
Anglica	27,449.75	11/24/33	19.40	18.58	10,200.90
Port	21,072.55	11/27/33	20.00	10.50	4,427.94
Sherry	14,485.48	11/29/33	19.90	10.18	2,948.24
Sherry	25,628.65	11/30/33	21.30	10.79	5,627.80
Port	17,454.59	12/3/33	21.00	16.41	5,729.80
Sherry	15,259.82	12/5/33	19.10	9.45	2,884.16
Sherry	19,676.99	12/7/33	20.60	11.55	4,547.31
Sherry	18,218.80	12/9/33	20.40	11.02	4,013.51
Sherry	18,086.62	10/10/33	21.80	13.85	5,011.16
Sherry	26,751.24	12/12/33	23.50	13.27	7,100.35

Kind of Wine	Wine Gallons	Date of Fortification	Per Cent of Alcohol in Wine After Fortification	Per Cent of Brandy in Fortified Wine	Proof Gallons of Brandy in the Wine
Sherry	26,920.53	12/13/33	22.20	12.85	6,926.12
Sherry	20,002.83	12/17/33	22.30	10.79	4,317.71
Sherry	25,735.39	12/19/33	21.00	9.55	4,904.01
Sherry	26,776.73	12/26/33	22.60	11.56	6,083.84
Muscat	15,082.02	1/4/34	19.40	10.84	5,269.22
Sherry	15,253.45	1/4/34	19.40	6.05	1,846.01
Claret	1,364.00				
660,470.97		Total,			194,963.16
Rate of Floor Tax					.10
Amount of Tax Due					19,496.32

I swear (or affirm) that the above is a true and complete inventory of all fortified wines produced and held for sale or use in the manufacture or production of any article intended for sale by the person, firm, or corporation named above on the day specified.

(Signed) MOUNT TIVY WINERY, INC.

By (signed) L. POWERS, Jr.

President.

(State whether owner, member of firm, or, if officer of corporation, give title).

Sworn to and subscribed before me this 6th day of February, 1934

(Signed) TARANCE S. MAGEE,

(Name)

Notary Public

(Title)

Fresno County, Calif. [63]

XXV.

This inventory showed that plaintiff held 639,-106.97 gallons of wine containing 194,963.16 proof gallons of brandy upon which a tax was believed to be due of \$19,496.32.

XXVI.

On February 10, 1934 the plaintiff paid the defendant John V. Lewis as Collector of Internal Revenue the sum of \$2,000.00. Subsequently on February 17, 1934 the plaintiff addressed a letter to the defendant John V. Lewis in which it stated that the \$2,000.00 paid to him represented a tax liability on brandy in fortified wine in the hands of the plaintiff and that the remaining balance of \$17,496.32 represented the tax on the brandy in the fortified wine held by the Fidelity Warehouse Company, and asserted that the Fidelity Warehouse Company held full possession and control of the wine and brandy as a bailee or warehouseman for the Bank of America. Plaintiff in the letter further protested the payment of any tax assessed or levied against the wine or brandy held by the Fidelity Warehouse Corporation upon the ground that the wines and brandy were not held by the producer on the date the Internal Liquor Taxing Act of 1934 became effective.

XXVII.

On April 11, 1934 the Commissioner of Internal Revenue assessed against the plaintiff taxes in the sum of \$19,496.32, the amount returned by the plaintiff on Form 756.

XXVIII.

On November 10, 1934, after the Commissioner of Internal Revenue had rejected claims in abatement of \$17,496.32 in taxes submitted by the plaintiff, the plaintiff upon demand by the defendant John V. Lewis paid to him the sum of \$17,496.32, the unpaid balance of the assessed tax and the sum of \$1,558.53, the amount of the interest accrued on the unpaid balance of the tax [64] as of November 10, 1934, a total of \$19,054.85, which amount together with the \$2000.00 previously paid made a grand total of \$21,054.85.

XXIX.

On August 28, 1935 the plaintiff filed with the defendant John V. Lewis a claim for the refund of \$15,419.33, which claim for refund was rejected by the Commissioner of Internal Revenue on July 29, 1936 by a registered letter bearing that date.

XXX.

The plaintiff filed the complaint on July 28, 1938 and thereafter served the United States Attorney on January 30, 1939 and served the Attorney General of the United States on February 28, 1939. The service on the United States Attorney and the Attorney General of the United States were made more than two years after the date of the mailing of the notice of rejection of the claim for refund by the Commissioner of Internal Revenue.

CONCLUSIONS OF LAW

I.

That the action against the United States of America was not commenced until plaintiff served a copy of its complaint upon the United States Attorney and the Attorney General of the United States.

II.

That the action against the United States of America was not commenced within the two-year limitation allowed by 26 USCA § 3772 (a)(2).

III.

That the Court does not have jurisdiction of the action against the defendant the United States of America. [65]

IV.

The Court does have jurisdiction of the action against the defendant John V. Lewis.

V.

That § 10 (c) of The Liquor Taxing Act of 1934 levies an excise tax.

VI.

That § 10(c) of The Liquor Taxing Act of 1934 does not violate Art. I, Sec. 2, Cl. 3, and Art. I, Sec. 9, Cl. 4 of the United States Constitution.

VII.

That § 10(c) of The Liquor Taxing Act of 1934

does not violate the Fifth Amendment to the Constitution of the United States.

VIII.

That within the meaning of Section 10 (c) of The Liquor Taxing Act of 1934, 26 USCA Section 451 (b), 1934 Cumulative Annual Pocket Part, the plaintiff was the producer of the 484,000 Gallons of fortified wine stored with the Fidelity Warehouse Corporation on January 12, 1934 in Public Bonded Storeroom No. 3728.

IX.

That within the meaning of Section 10(c) of The Liquor Taxing Act of 1934, 26 USCA 451 (b), 1934 Cumulative Annual Pocket Part, the plaintiff held the 484,000 gallons of fortified wine stored with the Fidelity Warehouse Corporation on January 12, 1934 in Public Bonded Storeroom No. 3728.

X.

That within the meaning of Section 10(c) of the Liquor Taxing Act of 1934, 26 USCA 451 (b), 1934 Cumulative Annual Pocket Part, the plaintiff intended to sell the 484,000 gallons of fortified wine stored with the Fidelity [66] Warehouse Corporation on January 12, 1934 in Public Bonded Storeroom No. 3728, or use it in the manufacture or production of articles intended for sale.

XI.

That under the provisions of § 10 (c) of The Liquor Taxing Act of 1934, 26 USCA 451(b), 1934 Cumulative Annual Pocket Part the plaintiff was

liable for an Internal Revenue Tax of \$14,792.71 on the 484,000 gallons of fortified wine stored with the Fidelity Warehouse Corporation on January 12, 1933 in Public Bonded Storeroom No. 3728.

XII.

That on October 31, 1934 the plaintiff was liable for \$1,558.53 in interest on the unpaid Internal Revenue Taxes for which it was liable under the provisions of § 10 (c) of The Liquor Taxing Act of 1934, 26 USCA 451 (b), 1934 Cumulative Annual Pocket Part.

XIII.

That the \$15,419.33 paid by the plaintiff to the defendants and sought to be recovered in this action was rightfully and correctly paid and the plaintiff is not entitled to its return or any portion thereof.

XIV.

That the defendant John V. Lewis is entitled to a judgment of dismissal and for his costs of suit herein incurred.

XV.

That the defendant United States of America is entitled to a judgment of dismissal and for its costs of suit herein incurred.

Dated: This 20th day of February, 1942.

A. F. ST. SURE,

United States District Judge.

Receipt of Service.

[Endorsed]: Filed Feb. 20, 1942. [67]

In the Southern Division of the United States District Court for the Northern District of California.

No. 20473-S

MOUNT TIVY WINERY, INC., a California Corporation,

Plaintiff,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District,

JOHN DOE, Collector of Internal Revenue, First
California District,

UNITED STATES OF AMERICA, FIRST DOE,
SECOND DOE, and THIRD DOE,
Defendants,

JUDGMENT ON FINDINGS

This cause came on regularly for trial upon the 12th day of November, 1941, before the Court sitting without a jury, trial by jury having been waived by oral stipulation, Robert H. Fouke, Esq., appearing as Attorney for plaintiff, and Frank J. Hennessy, United States Attorney and W. F. Mathewson, Assistant United States Attorney appearing as Attorneys for the defendants the United States of America and John V. Lewis, and the cause having been submitted upon a Stipulation of Facts for consideration and decision, and the [68] Court after due deliberation having rendered

its decision and filed its Findings and ordered that judgment be entered in accordance with the findings;

Now, Therefore, by virtue of the law and by reason of the findings aforesaid, It Is Ordered by the Court:

I.

That the defendant John V. Lewis be and he is hereby dismissed.

II.

That the defendant the United States of America be and it is hereby dismissed.

III.

That this action be and it is hereby dismissed and that the plaintiff recover nothing.

IV.

That the plaintiff pay to the defendants and each of them their costs of suit herein expended in the amounts to be taxed by the Clerk.

Judgment entered this 3rd day of April 1942.

A. F. ST. SURE,

United States District Judge.

Approved as to form as provided by Rule 22.

ROBERT H. FOUKE,

Attorney for Plaintiff.

[Endorsed]: Filed April 3, 1942. [69]

In the Southern Division of the United States District Court for the Northern District of California.

No. 20464-R

CALIFORNIA WINERIES AND DISTILLERIES, INC., a California corporation,
Plaintiff,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Collector of Internal Revenue, First California District, UNITED STATES OF AMERICA, FIRST DOE, SECOND DOE and THIRD DOE,

Defendants.

No. 20465-L

FRESNO WINERY INC., a California Corporation formerly known as Elsinore Winery, Inc., a corporation, and LUCERNE WINERY, INC., a corporation,

Plaintiff,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Collector of Internal Revenue, First California District, UNITED STATES OF AMERICA, FIRST DOE, SECOND DOE and THIRD DOE,

Defendants.

No. 20466-R

SANTA LUCIA WINERIES, INC., a California corporation,

Plaintiff,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Collector of Internal Revenue, First California District, UNITED STATES OF AMERICA, FIRST DOE, SECOND DOE and THIRD DOE,

Defendants.

No. 20467-S

CHARLES DUBBS and SAMUEL CAPLAN, co-partners doing business under the first name and style of ALTA WINERY AND DISTILLERY,

Plaintiffs,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Collector of Internal Revenue, First California District, UNITED STATES OF AMERICA, FIRST DOE, SECOND DOE and THIRD DOE,

Defendants.

No. 20474-W

CALIFORNIA GROWERS WINERIES, INC.,
a California corporation,

Plaintiff,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Collec-
tor of Internal Revenue, First California Dis-
trict, UNITED STATES OF AMERICA,
FIRST DOE, SECOND DOE and THIRD
DOE,

Defendants.

[71]

No. 21113-L

ST. GEORGE WINERY, a California corpora-
tion,

Plaintiff,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Collec-
tor of Internal Revenue, First California Dis-
trict, UNITED STATES OF AMERICA,
FIRST DOE, SECOND DOE and THIRD
DOE,

Defendants.

ORDER FOR JUDGMENT

These are companion cases to Mount Tivy Win-
ery, Inc., v. John V. Lewis, Collector of Internal
Revenue, etc., United States of America, et al., No.
20473-S, and are governed by the decision made
in that case this day.

On the jurisdictional question, I find that in three cases, i. e., No. 20464-R, No. 20474-W, and No. 21113-L, service on defendant United States was made within the two-year limitation, and therefore suit against the United States would stand. However, in view of my decision against plaintiffs, this becomes immaterial.

It is therefore Ordered:

That plaintiffs take nothing by their actions, and that defendants be dismissed with costs in each.

Counsel for defendants may prepare and submit [72] findings of fact, conclusions of law, and judgment in each case, in accordance herewith.

Dated: January 10, 1942.

A. F. ST. SURE,

United States District Judge.

[73]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF MOUNT TIVY
WINERY, INC.

Notice Is Hereby Given that Mount Tivy Winery, Inc., a California Corporation, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated: July 3, 1942.

ROBERT H. FOUKE,

Attorney for Plaintiff and
Appellant.

[Endorsed]: Filed July 3, 1942. [74]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF CALIFORNIA
WINERIES AND DISTILLERIES, INC.

Notice Is Hereby Given that California Wineries and Distilleries, Inc., a California Corporation, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated July 3, 1942.

ROBERT H. FOUKE,
Attorney for Plaintiff and
Appellant.

[Endorsed]: Filed July 3, 1942. [75]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF
FRESNO WINERIES, INC.

Notice Is Hereby Given that Fresno Winery, Inc., a California corporation formerly known as Elsinore Winery, Inc., a corporation, and Lucerne Winery, Inc., a corporation, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated July 3, 1942.

ROBERT H. FOUKE,
Attorney for Plaintiff and
Appellant.

[Endorsed]: Filed July 3, 1942. [76]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF SANTA LUCIA
WINERIES, INC.

Notice Is Hereby Given that Santa Lucia Wineries, Inc., a California Corporation, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated July 3, 1942.

ROBERT H. FOUKE

Attorney for Plaintiff and
Appellant.

[Endorsed]: Filed July 3, 1942. [77]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF CHARLES DUBBS
AND SAMUEL CAPLAN

Notice Is Hereby Given that Charles Dubbs and Samuel Caplan, co-partners doing business under the firm name and style of Alta Winery and Distillery, plaintiffs above named, hereby appeal to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated July 3, 1942.

ROBERT H. FOUKE

Attorney for Plaintiffs and
Appellants.

[Endorsed]: Filed July 3, 1942. [78]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF CALIFORNIA
GROWERS WINERIES, INC.

Notice Is Hereby Given that California Growers Wineries, Inc., a California Corporation, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated July 3, 1942.

ROBERT H. FOUKE

Attorney for Plaintiff and
Appellant.

[Endorsed]: Filed July 3, 1942. [79]

[Title of District Court and Cause.]

NOTICE OF APPEAL OF ST. GEORGE
WINERY

Notice Is Hereby Given that St. George Winery, a California Corporation, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on April 3, 1942.

Dated July 3, 1942.

ROBERT H. FOUKE

Attorney for Plaintiff and
Appellant.

[Endorsed]: Filed July 3, 1942. [80]

[Title of District Court and Cause.]

STIPULATION AND ORDER CONSOLIDATING CASES ON APPEAL, ETC.

Whereas, pursuant to stipulation and order of the above entitled Court, the above entitled actions were consolidated for all purposes, including hearing, trial and judgment in the above action entitled "Mount Tivy Winery, Inc., a California Corporation, plaintiffs, vs. John V. Lewis, Collector of Internal Revenue, First California District, John Doe, collector of Internal Revenue, First California District, United States of America, First Doe, Second Doe and Third Doe, defendants", in Proceeding No. 20473-S; and,

Whereas, separate Stipulations of Facts, Findings of Facts and Conclusions of Law and Judgments were filed in each of the above actions based upon the facts therein contained but predicated upon the determination as to the law applicable thereto by the above entitled Court, which law applicable thereto, insofar as any appeal to the Circuit Court of Appeals is involved, will be the same in each and every one of the above entitled cases; and,

Whereas, all parties plaintiff and defendant are represented by Robert H. Fouke and Frank J. Hennessy, United States Attorney, respectively;

Now Therefore it Is Hereby Stipulated by and between each and every plaintiff and defendant above named, by and through their respective attorneys as follows:

1. That for all purposes, including appeal, appeal bond, hearing, trial, judgment and costs, each and every one of the above entitled actions may be, and, pursuant to order of Court endorsed hereon, are consolidated with and in the above entitled action entitled "Mount Tivy Winery, Inc., a California corporation, plaintiff, vs. John V. Lewis, Collector of Internal Revenue, First California District, John Doe, Collector of Internal Revenue, First California District, United States of America, First Doe, Second Doe [83] and Third Doe, defendants, Proceeding No. 20473-S", and all papers filed in or motions, proceedings, orders or judgments made, taken, had or entered in said last named action shall be considered and be deemed to have been made, taken, had and entered in each and every one of the above entitled actions for all purposes save and except that in the event of the entry of a judgment in favor of the plaintiff in said action it is understood and agreed that no judgment will be entered in favor of any other plaintiff named in any or all of the above entitled actions in excess of the amount or amounts set forth in the respective stipulation of Facts filed in each respective action or otherwise authorized by law;

2. That whatever judgment may be entered in connection with any Appeal in the proceeding numbered 20473-S shall be applicable, insofar as the law involved is concerned, to each and every one of the above entitled actions, and judgments may and shall be entered therein, respectively, in conformity with

the judgment as to the law in proceeding number 20473-S to the same force and effect as if pronounced separately in a separate appeal, hearing and judgment in each of the above entitled actions;

3. That the filing of a separate Bond on Appeal as otherwise required by law and Rule 73(c) of the Federal Rules of Civil Procedure, upon an appeal being taken in each of the above entitled actions, be and the same is, pursuant to order of court endorsed hereon, dispensed with except in Proceeding No. 20473-S, in which case the Bond on Appeal therein filed shall be in the sum of Two Hundred and Fifty Dollars (\$250.00) and shall be applicable to each and all of the above entitled actions as provided in Rule 73(c) and in lieu of any additional or other Bond [84] on Appeal in any or all of the above entitled actions;

4. That for all purposes all papers, bonds or documents duly filed or introduced in Proceeding Number 20473-S, in connection with the appeal to the Circuit Court of Appeals therein, shall be deemed to have been duly filed or introduced in each of the above entitled actions; and

5. That this Stipulation is made in order to avoid unnecessary expenditure of time and money and the otherwise necessity of separate appeals, multiplicity of bonds, papers, motions, proceedings and judgments in each of the above entitled actions, it being the understanding and agreement that the appeal in proceeding Number 20473-S shall be in lieu and in the place and stead of separate appeals, pro-

ceedings and judgments in each of the above entitled actions yet shall be applicable thereto as if full proceedings on appeal had been entertained in each and every one of the above entitled actions subject only to the reservations herein contained.

ROBERT H. FOUKE

Attorney for Plaintiff and
Appellants, California Win-
eries and Distilleries, Inc.,
a California Corporation;
Fresno Winery Inc., etc.;
Santa Lucia Wineries, Inc.,
a California Corporation;
Charles Dubbs and Samuel
Caplan, co-partners doing
business under the firm
name and style of Alta
Winery and Distillery;
Mount Tivy Winery, Inc.,
a California Corporation;
California Growers Winer-
ies Inc., a California corpo-
ration; and St. George Win-
ery, a California Corpora-
tion.

FRANK J. HENNESSY

Per W. F. M.,

Attorney for Defendants and
Appellees, John V. Lewis
and United States of
America. [85]

ORDER

Good Cause Appearing Therefor,

It Is Hereby Ordered:

(1) That the foregoing Stipulation be and the same is hereby ratified, confirmed and approved;

(2) That each and all of the above entitled actions be and they are hereby consolidated for all purposes on appeal to the Circuit Court of Appeals for the Ninth Circuit with and in Proceeding Number 20473-S in accordance with and pursuant to the foregoing Stipulation, and that a single Bond on Appeal is hereby fixed in the sum of Two Hundred and Fifty Dollars (\$250.00), as provided in Rule 73(c) of the Federal Rules of Civil Procedure, and shall be filed with the appeal to the Circuit Court of Appeals for the Ninth Circuit in Proceeding Number 20473-S, which Bond on Appeal shall be in lieu and in the place and stead of separate Bonds on Appeal in each of the above entitled actions and shall be applicable thereto for all purposes.

Done in open court this 2nd day of July, 1942.

A. F. ST. SURE

Judge of the District Court.

[Endorsed]: Filed July 3, 1942. [86]

[Title of District Court and Cause.]

DESIGNATION OF RECORD ON APPEAL

Pursuant to Rule 75(a) of the Rules of Civil Procedure for the District Courts of the United States, the Appellants designate that there be included in the record on appeal the complete record in the action entitled "Mount Tivy Winery, Inc., a California corporation, plaintiff, vs. John V. Lewis, Collector of Internal Revenue, First California District, John Doe, Collector of Internal Revenue, First California District, United States of America, First Doe, Second Doe and Third Doe, defendants, Proceeding No. 20473-S" and all proceedings and evidence in this said action, save and except that the following records therein, namely:

- (1) Memorandum of Defendant's Points and Authorities;
- (2) Memorandum of Defendants John V. Lewis and The United States of America;
- (3) Reply Brief to Memorandums of Defendants' Points and Authorities; and
- (4) Defendants' Closing Brief,

and any other brief of points and authorities, shall be excluded from the record on appeal.

ROBERT H. FOUKE

Attorney for Appellants, California Wineries and Distilleries, Inc., a California corporation; Fresno Winery, Inc., etc.; Santa Lucia Win-

eries Inc., a California corporation; Charles Dubbs and Samuel Caplan, co-partners doing business under the firm name and style of Alta Winery and Distillery; Mount Tivy Winery, Inc., a California corporation; California Growers Wineries Inc., a California corporation; and St. George Winery, a California corporation.

Received copy of the within Designation of Record on Appeal this 3rd day of July, 1942.

FRANK J. HENNESSY

per W F M

Attorney for Defendants and
Appellees John V. Lewis
and United States of America.

[Endorsed]: Filed July 3, 1942. [89]

[Title of District Court and Cause.]

STIPULATION TRANSMITTING ORIGINAL
EXHIBITS AND ORDER APPROVING
SAME

It Is Stipulated by and between counsel for the above entitled parties that the Clerk of this Court, as provided by law and in conformity with Rule 75

of the Rules of Civil Procedure, shall transmit to the clerk of the Circuit Court of Appeals for the Ninth Circuit the following designated portions of the records, proceedings and evidence in this cause, certifying those portions thereof that are necessary to be certified pursuant to said rules or pursuant to the rules of said Circuit Court of Appeals, all of the costs thereof to be paid by the Plaintiff- [90] Appellant; and the original Exhibits forwarded pursuant to Rule 75 (i) shall be held by the clerk of the appellate court pending the appeal and thereafter returned to the clerk of this court;

Copies of the following Exhibits attached to the Stipulation of Facts filed in the above entitled action and designated by Exhibit Number, namely,

List of Exhibits—Mount Tivy Winery, Inc.
Exhibit No.

- “A” Treasury Decision No. 19—Gen’l. Circular No. 141.
- “B” Application for Permit Form 1404.
- “C” Permit to operate—Form 1405.
- “D” Blanket Bond—Form 1530 A.
- “E” Blanket Bond—Form 699 A.
- “F” Monthly Report—Form 702.
- “G” Field Warehouse Storage Agreement.
- “H” Field Warehouse Lease.
- “I” Warehouse Receipt No. 01304.
- “J” Warehouse Receipt No. 01307.
- “K” Warehouse Receipt No. 01312.
- “L” Warehouse Receipt No. 01316.
- “M” Promissory Notes.

- “M-1” Collateral Agreement.
- “N” Order for Warehouse Release.
- “O” A & C Mimeo Coll. No. 4132.
- “P” Mimeo Letter “Floor Tax on Distilled
Spirits, Wines, Etc.
- “Q” Inventory & Return—Form 756.
- “R” Letter of Protest.
- “S” Claim in Abatement.
- “T” Claim in Abatement.
- “U” Receipt for payment of Taxes—Form 1.
- “V” Notice and Demand for Tax—Form 17.

It Is Further Stipulated that the Plaintiff-Appellant [91] shall not file two copies of the Reporter's Transcript as provided for in Rule 75(b).

ROBERT H. FOUKE

Attorney for Plaintiff & Appellant.

FRANK J. HENNESSY

per W F M

Attorney for Defendants & Appellees.

It is so ordered.

MICHAEL J. ROCHE

United States District Judge.

Dated: July 10th, 1942.

[Endorsed]: July 10, 1942. [92]

[Title of District Court and Cause.]

COST BOND ON APPEAL

Know All Men By These Presents :

That we, California Wineries and Distilleries, Inc., a California corporation, Fresno Winery, Inc., a California corporation, (formerly known as Elsinore Winery, Inc., a corporation, and Lucerne Winery, Inc., a corporation,) Santa Lucia Wineries, Inc., a California corporation, Alta Winery and Distillery, a copartnership consisting of Charles Dubbs and Samuel Caplan, copartners, Mount Tivy Winery, Inc., a California corporation, California Growers Wineries, Inc., a California corporation, and St. George Winery, a California corporation, as Principal, and The Western Casualty & Surety Company [94] a corporation organized and existing under the laws of the State of Kansas and authorized to transact a surety business in the State of California, as Surety, are held and firmly bound unto John V. Lewis, Collector of Internal Revenue First California District, and United States of America, in the full and just sum of Two Hundred and Fifty and No/100 (\$250.00) Dollars, to be paid to the said John V. Lewis, Collector of Internal Revenue First California District and United States of America, their certain attorney, executors, administrators or assigns; to which payment well and truly to be made, we bind ourselves, our heirs, executors, and administrators, jointly and severally, by these presents.

Sealed with our seals and dated this 3 day of July, 1942.

Whereas, lately at the District Court of the United States for the Northern District of California, Southern Division, in a suit pending in said Court, between California Wineries and Distilleries, Inc., a California corporation, No. 20464-S, Fresno Winery, Inc., a California corporation, (formerly known as Elsinore Winery, Inc., a corporation, and Lucerne Winery, Inc., a corporation) No. 20465-S, Santa Lucia Wineries, Inc., a California corporation, No. 20466-S, Alta Winery and Distillery, a copartnership consisting of Charles Dubbs and Samuel Caplan, copartners, No. 20467-S, Mount Tivy Winery, Inc., a California corporation, No. 20473-S, California Growers Wineries, Inc., a California corporation, No. 20474-S, and St. George Winery, a California corporation, No. 21113-S, against John V. Lewis, Collector of Internal Revenue First California District and United States of America, judgments were rendered against California Wineries and Distilleries, Inc., a California corporation, Fresno Winery, Inc., a California corporation (formerly known as Elsinore Winery, Inc., a corporation, and Lucerne Winery, Inc., a corporation), Santa Lucia Wineries, Inc., a California corporation, Alta Winery and Distillery, a copartnership consisting of Charles Dubbs and Samuel Caplan, copartners, Mount Tivy Winery, Inc., a California corporation, California Growers Wineries, Inc., a California corporation, and St. George Winery, a

California corporation, and the said plaintiffs above named have each separately filed notice of appeal to the United States Circuit Court of Appeals for the Ninth Circuit, in the State [95] of California.

Now, Therefore, the condition of the above obligation is such, that if the said California Wineries and Distilleries, Inc., a California corporation, Fresno Winery, Inc., a California corporation, Santa Lucia Wineries, Inc., a California corporation, Alta Winery and Distillery, a copartnership consisting of Charles Dubbs and Samuel Caplan, copartners, Mount Tivy Winery, Inc., a California corporation, California Growers Wineries, Inc., a California corporation, and St. George Winery, a California corporation, shall prosecute their appeal to effect, and answer all costs if they fail to make their pleas good, then the above obligation to be void; else to remain in full force and virtue.

This recognizance shall be deemed and construed to contain the "consent and agreement" for summary judgment and execution thereon mentioned in Rule #13 of the District Court.

Acknowledged before me the day and year first above written.

CALIFORNIA WINERIES AND
DISTILLERIES, INC.

By CHAS. J. YOUNGBERG

Attorney in fact

FRESNO WINERY, INC.

By CHAS. J. YOUNGBERG

Attorney in fact

Mount Tivy Winery

SANTA LUCIA WINERIES,
INC.

By CHAS. J. YOUNGBERG

Attorney in fact

ALTA WINERY AND DISTIL-
LERY, a copartnership consist-
ing of Charles Dubbs and Sam-
uel Caplan

By CHAS. J. YOUNGBERG

Attorney in fact

MOUNT TIVY WINERY, INC.

By CHAS. J. YOUNGBERG

Attorney in fact [96]

CALIFORNIA GROWERS
WINERIES, INC.

By CHAS. J. YOUNGBERG

Attorney in fact

ST. GEORGE WINERY

By CHAS. J. YOUNGBERG

Attorney in fact

The premium charged for this bond is \$10.00 Dol-
lars per annum.

[Seal]

THE WESTERN CASUALTY
& SURETY COMPANY

By M. HENDERSON

Attorney in fact

Examined and recommended for approval as pro-
vided in Rule #13.

ROBERT H. FOUKE,

Attorney

(Duly Verified)

[Endorsed]: Filed Jul 3, 1942. [97]

In the Southern Division of the United States
District Court for the Northern
District of California.

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD

I, Walter B. Maling, Clerk of the District Court of the United States, for the Northern District of California, do certify that the foregoing 97 pages, numbered 1 to 97, inclusive, contain a full, true, and correct transcript of the records and proceedings in the Mount Tivy Winery, Inc. vs. John V. Lewis, etc. et al., Case No. 20473-S as the same now remain on file and of record in my office.

I do hereby further certify that exhibits marked Nos. A to V, both inclusive, were filed in this case, and pursuant to order of court, are herewith forwarded to the United States Circuit Court of Appeals for the Ninth Circuit, to be considered by it as part of the record on appeal herein.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of Fourteen and 30/100 (\$14.30) Dollars and that the said amount has been paid to me by the Attorney for the appellant herein.

In witness whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 11th day of August, A. D. 1942.

[Seal]

WALTER B. MALING,
Clerk.

By HARRY L. FOUTS,
Deputy Clerk. [98]

[Endorsed]: No. 10220. United States Circuit Court of Appeals for the Ninth Circuit. Mount Tivy Winery, Inc., a Corporation, Appellant, vs. John V. Lewis, Collector of Internal Revenue, First California District, and United States of America, Appellees. California Wineries and Distilleries, Inc., a Corporation, Appellant, vs. John V. Lewis, Collector of Internal Revenue, etc., and United States of America, Appellees. Fresno Winery, Inc., a Corporation, etc., Appellant, vs. John V. Lewis, Collector of Int. Revenue, et al., Appellees. Santa Lucia Wineries, Inc., a Corporation, Appellant, vs. John V. Lewis, Collector of Int. Revenue, et al., Appellees. Charles Dubbs and Samuel Caplan, Co-partners doing business as Alta Winery and Distillery, Appellants, vs. John V. Lewis, Collector of Int. Revenue, et al., Appellees. California Growers Wineries, Inc., a Corporation, Appellant, vs. John V. Lewis, Collector of Int. Revenue, et al., Appellees. St. George Winery, a Corporation, Appellant, vs. John V. Lewis, Collector of Int. Revenue, et al., Appellees. Transcript of Record. Upon Appeals from the District Court of the United States for the Northern District of California, Southern Division.

Filed August 12, 1942.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals
For the Ninth Circuit

No. 10220

MOUNT TIVY WINERY, INC., a California
Corporation, et als.,

Appellants,

vs.

JOHN V. LEWIS, Collector of Internal Revenue,
First California District, JOHN DOE, Col-
lector of Internal Revenue First California
District, UNITED STATES OF AMERICA,
FIRST DOE, SECOND DOE and THIRD
DOE,

Appellees.

STATEMENT OF POINTS UPON WHICH
APPELLANTS INTEND TO RELY ON
THE APPEAL

In support of its appeal in this proceeding, the appellants will rely upon the following points:

1. Since all the evidence was contained in Stipulations of Fact, and there was no controversy as to the facts, in each of the respective cases consolidated in this appeal, only a question of law was presented to the trial court.

2. The trial court erred as a matter of law in holding that Section 10 (c) of the Liquor Taxing Act of 1934 levies an excise tax.

3. The trial court erred as a matter of law in holding that Section 10 (c) of the Liquor Taxing

Act of 1934 does not violate Art. I, Sec. 2, Cl. 3, and Art. I, Sec. 9, Cl. 4 of the United States Constitution.

4. The trial court erred as a matter of law in holding that Section 10 (c) of The Liquor Taxing Act of 1934 does not violate the Fifth Amendment to the Constitution of the United States.

5. The trial court erred as a matter of law in holding that within the meaning of Section 10 (c) of The Liquor Taxing Act of 1934, 26 USCA 451 (b), 1934 Cumulative Annual Pocket Part, the appellants held the specified quantities of wine set forth in the findings of fact, conclusions of law and respective judgments in each of the cases herein consolidated and appealed.

6. The trial court erred as a matter of law in holding that the appellants intended to sell the wine so stored in bonded storerooms or use it in the manufacture or production of articles intended for sale.

7. The trial court erred as a matter of law in holding that appellants and each of them, was subject to the provisions of said Liquor Taxing Act and was liable for an Internal Revenue Tax in the amount set forth in the findings of fact, conclusions of law and judgments entered in the respective cases before the United States District Court, herein consolidated and appealed.

8. The trial court erred as a matter of law in holding that appellants and each of them was subject to and liable for the respective sums set forth

in the findings of fact, conclusions of law and judgments in interest on the unpaid Internal Revenue taxes under the provisions of Section 10 (c) of the Liquor Taxing Act of 1934, USCA 451 (b), 1934 Cumulative Annual Pocket Part.

9. The trial court erred as a matter of law in holding that the respective sums of principal and interest set forth in the findings of fact, conclusions of law and judgments entered in each of the respective cases before the District Court of Appeals and consolidated in this case on appeal was rightfully and correctly paid and that appellants and each of them was not entitled to its return or any portion thereof.

10. The trial court erred as a matter of law in holding that appellees John V. Lewis and United States of America were entitled to a judgment of dismissal and for costs of suit incurred in said action.

Dated: August 24, 1942.

ROBERT H. FOUKE

Attorney for Appellants.

Received copy of foregoing Statement of Points
this 24th day of August, 1942.

FRANK J. HENNESSY,

per WFM

Attorney for Appellees.

[Endorsed]: Filed Aug. 24, 1942.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF RECORD

In accordance with Rule 19, appellants designate the entire record as necessary for the consideration of this proceeding. In the Court below, appellants have designated the complete record for inclusion, in accordance with Rule 75 (a) of the Federal Rules of Civil Procedure, excluding the Memorandum of Legal Points and Authorities therefrom, as set forth in said Designation of Record on Appeal filed July 3, 1942 in said Court.

In this Court, appellants designate and respectfully request the printing of the Transcript of Record on Appeal, prepared by the Clerk of the District Court, excluding therefrom certain voluminous exhibits which, pursuant to Stipulation and Order dated the 21st day of August, 1942, are authorized to be incorporated by reference but eliminated from the printed record.

Dated: August 24, 1942.

ROBERT H. FOUKE

Attorney for Appellants.

Received copy of foregoing Designation this 24th day of August, 1942.

FRANK J. HENNESSY

per WFM

Attorney for Appellees

[Endorsed]: Filed Aug. 24, 1942.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION AND ORDER THAT CERTAIN
VOLUMINOUS EXHIBITS NEED NOT BE
COPIED IN THE RECORD BUT MAY BE
INCORPORATED BY REFERENCE

It Is Hereby Stipulated with the approval of the Court, by counsel for the respective parties herein, that in addition to the record on appeal heretofore agreed upon, the hereinafter enumerated original exhibits, which were introduced pursuant to stipulation at the trial of the above entitled cause, and which said exhibits now constitute a part of the record on appeal, may be incorporated in and made a part of the appeal by reference only without the necessity of printing such exhibits, said exhibits being specifically enumerated as follows:

List of Exhibits—

Mount Tivy Winery, Inc.

Exhibit No.

- “A” Treasury Decision No. 19—Gen’l. Circular No. 141
- “B” Application for Permit—Form 1404
- “C” Permit to Operate—Form 1405
- “D” Blanket Bond—Form 1530A
- “E” Blanket Bond—Form 699A
- “F” Monthly Report—Form 702
- “G” Field Warehouse Storage Agreement
- “H” Field Warehouse Lease
- “I” Warehouse Receipt No. 01304

- “J” Warehouse Receipt No. 01307
- “K” Warehouse Receipt No. 01312
- “L” Warehouse Receipt No. 01316
- “M” Promissory Notes
- “M-1” Collateral Agreement
- “N” Order for Warehouse Release
- “O” A & C Mimeo Coll. No. 4132
- “P” Mimeo Letter “Floor Tax on Distilled
Spirits, Wines, Etc.
- “Q” Inventory & Return—Form 756.
- “R” Letter of Protest
- “S” Claim in Abatement
- “T” Claim in Abatement
- “U” Receipt for payment of Taxes—Form 1.
- “V” Notice and Demand for Tax—Form 17.

It Is Further Stipulated with the approval of the Court that the above described Exhibits may be used as physical exhibits, neither printed in a book of Exhibits nor the Transcript as such Exhibits are bulky in nature and do not lend themselves to satisfactory and convenient or economic reproduction in printed form.

Dated this 21st day of August, 1942.

ROBERT H. FOUKE

Attorney for Appellants.

FRANK J. HENNESSY

per WFM

Attorney for Appellees.

It Is So Ordered this 23 day of August, 1942,
provided three copies of the exhibits in plain and
clear typing or photostats are furnished the court.

WILLIAM DENMAN

Judge of the United States
Circuit Court of Appeals
for the Ninth Circuit.

[Endorsed]: Filed Aug. 24, 1942.

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

District Court No. 20,473-S

MOUNT TIVY WINERY, INC. (a corporation), *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California
District, and UNITED STATES OF AMERICA, *Appellees*.

District Court No. 20,464-R

CALIFORNIA WINERIES AND DISTILLERIES, INC. (a corporation), *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California
District, and UNITED STATES OF AMERICA, *Appellees*.

District Court No. 20,465-L

FRESNO WINERY, INC. (a corporation), etc., *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees*.

District Court No. 20,466-R

SANTA LUCIA WINERIES, INC., (a corporation), *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees*.

District Court No. 20,467-S

CHARLES DUBBS and SAMUEL CAPLAN, Co-partners doing business
as ALTA WINERY AND DISTILLERY, *Appellants*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees*.

District Court No. 20,474-W

CALIFORNIA GROWERS WINERIES, INC. (a corporation), *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees*.

District Court No. 21,113-L

ST. GEORGE WINERY (a corporation), *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees*.

FILED

OCT 19 1942

APPELLANTS' OPENING BRIEF.

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PAUL P. O'B

CLERK

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No. 10,220

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

District Court No. 20,473-S

MOUNT TIVY WINERY, INC. (a corporation), *Appellant,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California
District, and UNITED STATES OF AMERICA, *Appellees.*

District Court No. 20,464-R

CALIFORNIA WINERIES AND DISTILLERIES, INC. (a corporation), *Appellant,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California
District, and UNITED STATES OF AMERICA, *Appellees.*

District Court No. 20,465-L

FRESNO WINERY, INC. (a corporation), etc., *Appellant,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 20,466-R

SANTA LUCIA WINERIES, INC., (a corporation), *Appellant,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 20,467-S

CHARLES DUBBS and SAMUEL CAPIAN, Co-partners doing business
as ALTA WINERY AND DISTILLERY, *Appellants,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 20,474-W

CALIFORNIA GROWERS WINERIES, INC. (a corporation), *Appellant,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

District Court No. 21,113-L

ST. GEORGE WINERY (a corporation), *Appellant,*
vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al., *Appellees.*

APPELLANTS' OPENING BRIEF.

STATEMENT REGARDING JURISDICTION.

These appeals arise from judgments entered by the District Court of the United States for the Northern District of California, Southern Division. The opinion by Judge St. Sure, which is similar to the opinions in each of the seven cases, except for amounts involved and jurisdiction over the defendant United States of America, is set forth on pages 37 to 47 of the transcript of record herein.

The joint appeal in these cases involves tax returns made by each of the appellants in 1934, pursuant to demands by defendant John V. Lewis, then Collector of Internal Revenue, and payments made thereafter of the taxes assessed thereunder, as provided in the Liquor Taxing Act of 1934, 26 U. S. C. A. 451 (b), 1934 Cumulative Annual Pocket Part, particularly Section 10 (c) thereof.

The seven appeals herein are taken jointly from the several judgments entered after trial below, pursuant to stipulation and order of the District Court consolidating said cases for trial in the District Court, in accordance with Rule 75 (k) Title 28, Rules of Procedure for the District Court of the United States, entered on April 3, 1942 (R. 85-90).

A stipulation and order consolidating these cases on appeal, etc., dated July 2, 1942, was filed July 3, 1942 (R. 94), as authorized under Rules 74 and 75 of the Federal Court Rules, Title 28, United States Code, pages 2652-3-4.

The notices of appeal were filed on July 3, 1942, pursuant to the provisions of Section 230, Title 28,

United States Code (Title 28, Section 230, U. S. C. A.) and Rule 73 Federal Court Rules, District Court of the United States, Title 28, United States Code, page 2651 and a cost bond on appeal was filed on the same date (R. 103-106).

The designation of record on appeal was filed July 3, 1942 (R. 99-100), and a stipulation transmitting original exhibits and order approving same dated July 10, 1942, was filed on said latter date.

The District Court took jurisdiction of the proceedings in all seven cases under the provisions of Section 41, subdivision 5, Title 28, United States Code, against defendant John V. Lewis, a former Collector of Internal Revenue and against the United States of America under the provisions of subdivision 20, Section 41, Title 28, United States Code.

The appellants paid to appellee, John V. Lewis, in his official capacity as Collector of Internal Revenue, the floor tax, interest and penalties in question in each case, at the time and in the respective amounts set forth in the respective stipulation of facts filed in each of these cases pending in the District Court of the United States, and, thereafter, each appellee filed a claim for refund in the manner and form provided by law, which respective claims for refund were formally rejected thereafter, as is set forth in said stipulations of fact, by letter from the Commissioner of Internal Revenue. Each of the instant actions was commenced within the statutory period of time against defendant John V. Lewis, Collector of Internal Revenue and was commenced within the statutory period

of time in cases No. 20,464-R, No. 20,474-W and No. 21,113-L (R. 43-90), in which appellants, California Wineries and Distilleries, Inc., a California corporation, California Growers Wineries, Inc., a California corporation, and St. George Winery, a California corporation, respectively, were plaintiffs.

This Court has jurisdiction to review by appeal the final decision of the District Court, under Section 225 (a), Title 28, United States Code (Section 128 (a), Judicial Code).

STATEMENT OF THE CASE.

The Issue.

The question involved, in each of these seven cases, is whether appellants herein were subject to the floor tax imposed by Section 10 (c) of the Liquor Taxing Act of 1934, 26 U. S. C. A. 451 (b), 1934 Cumulative Annual Pocket Part, provided as follows:

“Upon all wines *held* by the producer thereof upon January 12, 1934, *and intended for sale or for use in the manufacture or production of any article intended for sale*,¹ there shall be levied, assessed, collected and paid a floor tax equal to the amount, if any, by which the tax provided for under Section 443 of this title exceeds the tax paid upon the grape brandy or wine spirits used in the fortification of such wine.”

The liability of appellants and each of them respectively, to the tax depends upon: (a) whether each ap-

¹Italics supplied throughout by appellant.

pellant "held" the wines upon which the floor tax was imposed on January 12, 1934; (b) whether such wines were "held" by each appellant as a producer on said date; (c) whether such wines, if so "held" by each appellant as a producer were "intended for sale or for use in the manufacture or production of any article intended for sale"; and, (d) whether, if such wines were so "held" by each appellant, for any of said purposes enumerated, the tax, interest and penalty assessed and collected from each of the appellants was illegally imposed and collected on the grounds that the above Section 10 (c) of the Liquor Taxing Law of 1934, violates, (1) Article I, Section 2, Clause 3, (2) Article I, Section 9, Clause 4, and, (3) The Fifth Amendment to and of the Constitution of the United States, in that Section 10 (c) levies a direct tax without proper apportionment and imposes a tax upon one class of persons only, thereby depriving such class of the "equal protection of the law", under the due process clause.

Appellants, in each of the seven cases, made application for refund of the taxes paid, which applications were denied. In most of the cases, plaintiffs paid the taxes assessed under protest, after claims for abatement of the respective taxes were denied.

Appellants, in their respective complaints, claimed non-liability for the floor tax assessed and the tax, interest and penalty collected on the grounds:

That the tax, interest and penalty was illegally imposed and collected because:

(a) The wines, upon which the tax was imposed and the tax, interest and penalty collected, were not "held" legally or physically by appellants on the taxable date, namely, July 12, 1934;

(b) nor were said wines "held" by appellants as a producer, or at all, on the taxable date;

(c) nor were such wines so "held" by appellants as such producer and intended for sale or for use in the manufacture or production of any article intended for sale by appellants; and,

(d) Should it be found that appellants "held" the wines under (a), (b), or (c), that nevertheless the floor tax was illegally assessed and the tax, interest and penalty illegally collected from appellants because Section 10 (c) of the Liquor Taxing Act of 1934 is illegal and void, because it is a violation of: (1) Article I, Section 2, Clause 3; (2) Article I, Section 9, Clause 4; and, (3) The Fifth Amendment to and of the Constitution of the United States; in that said Section 10 (c) levies a direct tax without proper apportionment and imposes a tax upon one class of persons, thereby depriving such class of the "equal protection of the law" under the due process clause.

Concerning the argument that said law imposed a tax upon one class of persons, the District Court held that this ground could not be raised for the first time in argument without being properly pleaded.

Each complaint filed in the District Court contains two counts, in which the points raised in Paragraphs (a), (b), (c), and (d) above are set forth. In this

connection the District Court states in its opinion that: "*The first states a claim for recovery, if justified by the law and the evidence.* The second adopts the allegations of the first, by reference, and adds that Section 10 (c) of the Liquor Taxing Act of 1934, under the provisions of which the taxes were assessed and collected, violates Article I, Section 2, clause 3, and Article I, Section 9, clause 4 of the Constitution of the United States of America."

The Court below concluded (R. 47) "that the liquor in question was '*held*' by plaintiff within the meaning of Section 10 (c) on the effective date thereof", after first concluding (R. 43) that, in three of the companion cases, namely, No. 20,464-R, No. 20,474-W, and No. 21,113-L, service, as required by the Tucker Act, 28 U. S. C. A. §763, was made within the two year period specified in 26 U. S. C. A. Int. Rev. Code, §3773 (a) (2), so that in those cases the Court had jurisdiction of the United States, as well as the Collector of Internal Revenue over whom the Court had jurisdiction in all seven cases; also (R. 43), that the tax levied by Section 10 (c) is an excise tax, and as such, constitutional.

STATEMENT OF THE FACTS.

All of the cases below were submitted upon the basis of an agreed statement of facts in each case (R. 14).

Except for differences in the amount of the taxes, interest and penalties paid, and the location of the

bonded warehouses, a different corporate warehouseman and bank (hereinafter referred to as Warehouse Corporation or Bank, respectively, irrespective of the actual name of the warehouseman corporation or Bank), the facts in each of the cases are substantially the same.

Although the verbiage and figures used in the various notes, warehouse receipts, leases and agreements vary, such variance however, is not material, because only issues of law, applicable to all seven cases alike, are raised, upon the determination of which any judgment herein must be predicated.

These facts are set forth in a written stipulation and a supplemental stipulation of facts in the exhibits thereto attached (R. 14-36). The findings of fact by the Court below (R. 48-81) follow in general the written stipulations.

The conclusions of law (R. 82-84) set forth in Paragraphs I, II and III (R. 82) are the same substantially in all cases, except that in cases No. 20,564-R, No. 20,474-W and No. 21,113-L, the Court arrived at the opposite conclusion, to the effect that the actions were properly commenced against the United States of America within the statutory period of time, and that therein the Court had jurisdiction of said defendant United States of America. In all other particulars, with the exception of verbiage, figures, et cetera, the conclusions of law, insofar as material to these appeals, are similar.

Appellants, in each of the seven respective cases, oppose the conclusions of law set forth in Paragraphs

V to XV inclusive (R. 82-84), because appellants contend that they are contrary to the facts, as stipulated in the within stipulations of fact (R. 14-36), and the law and constitutional provisions noted.

The facts so stipulated may be summarized as follows: Appellants, with the exception that one appellant is a co-partnership, are corporations (R. 14-15, 49), duly organized and existing as such prior to January 12, 1934. Appellants were qualified to and were engaged in the manufacture, production and sale of wine intended for sale or for use in the manufacture or production of articles intended for sale in their respective bonded wineries, all being located within the Northern Division of the Southern District of California (R. 15, 49).

Defendant John V. Lewis was a resident of said Division and District, and was the duly appointed, qualified and acting Collector of Internal Revenue therein at the time of the assessment and collection of the taxes, but resigned, as such, prior to the filing of the respective complaints (R. 15, 49).

The respective actions were brought against Lewis as a former Collector of Internal Revenue, and the United States of America (R. 15, 49), as noted in the statement regarding jurisdiction (ante).

Prior to the enactment, on January 11, 1934, of Section 10 (c) of the Liquor Taxing Act of 1934, and the date on which said Act became effective and operative on January 12, 1934, (R. 19, 59),

I. The Warehouse Corporation.

A. Was duly organized and existing as a corporation;

B. Owned and operated a public warehouse business on the premises of each respective appellant under a written Field Warehouse Storage Agreement (Exhibit "G") and a Field Warehouse Lease (Exhibit "H"; R. 35), under the authority and pursuant to the laws of the State of California and Treasury Decision 19 and General Circular No. 141, approved September 16, 1933 (Exhibit "A"; R. 16, 51);

C. Had made application for a permit to the Supervisor of Permits, Bureau of Industrial Alcohol, under the laws and regulations governing the establishment of bonded wineries and storerooms, to establish a Public Bonded Storeroom (Exhibit "B"; R. 16, 51);

D. Obtained a permit (Exhibit "C") to establish said Public Bonded Storeroom or Warehouse (R. 16, 58);

E. Executed to the United States of America a blanket bond in the sum of \$100,000.00 on Form 1530A (Exhibit "E"; R. 16);

F. Thereafter was obliged to and did render monthly reports (Exhibit "F") to said defendant, accounting for all wines received, stored and removed from the bonded storeroom premises (R. 16-17);

G. Entered into, with each respective appellant, (a) A Field Warehouse Storage Agreement (R. 17,

59; Exhibit "G"), and, (b) a Field Warehouse Lease (Exhibit "H"; R. 19, 59);

H. Had issued, as such public warehouseman, under the laws of the State of California, the United States of America, and the rules and regulations of the Treasury Department, including T.D. No. 19 (Exhibit "A"; R. 27), pursuant to the request of each appellant (R. 20), warehouse receipts, negotiable in form, to the Bank or order, which receipts were issued and executed in the name of and were delivered, at the request of each appellant, on said dates, to said Bank, in accordance with and pursuant to the authority contained in the Articles of Incorporation and By-Laws of the warehouse corporation and the laws of the State of California (R. 20, 59-60);

I. Had released, subsequently, various quantities of the wine stored in its Public Bonded Storeroom to purchasers of the wine and their authorized agents at the request of said Bank, which Bank executed and delivered to the Warehouse Corporation an Order for Warehouse Release (Exhibit "N"; R. 21-71);

J. Had received from the Bank the Warehouse Receipt, negotiable in form, previously issued in the name and to the order of the Bank, for cancellation, or for endorsement thereon of the amount of the wine sold, or for issuance of a new warehouse receipt, negotiable in form, in the name of and to the order of the Bank, which endorsed or new warehouse receipts were thereafter returned to the Bank by the Warehouse Corporation (R. 26);

K. Had physical possession and control of all wines, following receipt thereof from appellants, at all times in its Public Bonded Warehouse until sold by the Bank and delivered by it pursuant to an Order for Warehouse Release to purchasers (R. 27, 64); and

L. Placed all wine, so delivered to it, in storage tanks located in and upon the leased premises; that signs were placed over and outside the entrances and inside the leased premises to the effect that said leased premises was the registered Public Bonded Storeroom of the Warehouse Corporation; that upon receipt of the wine from each appellant said Warehouse Corporation caused to be placed upon the tanks in which the wine was stored, stock cards showing that the wine was warehoused to said Bank, the description of the wine, the date of warehousing, the negotiable warehouse receipt number issued against the wine, and the quantity and quality of the wine therein stored; that locks were placed upon all entrances to the leased premises by the Warehouse Corporation and the key to each of said locks was in the possession of and was retained by the agent of the Warehouse Corporation in charge of the leased premises; that at all times the Warehouse Corporation caused to be employed its bonded agent to whom detailed printed instructions were given as to his duties; that the salary of said bonded agent was paid by the Warehouse Corporation; that no appellant was permitted access to the leased premises except through the bonded agent of the Warehouse Corporation in accordance with the terms of said written agreement herein

referred to, and then only under the observation and supervision of the bonded agent of the Warehouse Corporation; that the warehouse was opened and closed by the bonded agent who kept it locked at all times that he was not personally there, and said bonded agent received and delivered all merchandise at the leased premises.

That in accordance with the provisions of the Field Warehouse Storage Agreement, Exhibit "G", and in accordance with an understanding between each appellant and the Warehouse Corporation pursuant thereto, each appellant was, from time to time, permitted to have access to the said bonded storeroom for the purpose of servicing and caring for said wine during the period said wine was stored in said bonded storeroom (R. 27-29, 63-64);

II. The Bank had,

A. Received from appellant several promissory notes prepared by the Bank and executed to the order of the Bank by appellant, and thereafter, the collateral agreement (Exhibit "M1"), executed to the Bank by appellant (see Paragraph III, F. post);

B. Received from the Warehouse Corporation many of the warehouse receipts, negotiable in form, issued in the name and to the order of the Bank (see Paragraph I, H. ante), prior to the execution of the collateral agreement (Exhibit "M1"), and thereafter some of the original and some of the endorsed warehouse receipts;

C. Delivered to the Warehouse Corporation Orders for Warehouse Release of wine stored (see Paragraph I, I. ante), and redelivered Warehouse receipts, negotiable in form, previously delivered to the Bank by the Warehouse Corporation for endorsement thereon of sales and withdrawals of wine, cancellation thereof, or for reissuance and delivery to the Bank of new warehouse receipts, negotiable in form, in the name and to the order of the Bank (see Paragraph I, J. ante);

III. Each appellant had,

A. Entered into a Field Warehouse Storage Agreement (Exhibit "G"; R. 17-59) with the Warehouse Corporation, in writing, wherein, among other things, the Warehouse Corporation agreed to furnish appellant all field warehouse services necessary to appellant's business (R. 49-50), and appellant agreed to employ said Warehouse Corporation to furnish such services, subject to the terms and conditions and for the consideration therein set forth (R. 50); wherein the Warehouse Corporation (R. 7-18, 50) agreed:

1. To maintain a public warehouse in and upon the premises leased by the appellant to the corporation;

2. To furnish to the appellant all field warehouse services necessary to the appellant's business;

3. To place a bonded agent and/or bonded watchman in charge of the warehouse and leased premises; and,

4. To issue field warehouse receipts upon the property which the appellant might store therein; the agreement also provided, however, (a) that the Warehouse Corporation should be free from all liability for taxes, assessments, charges or penalties levied, assessed or imposed by a Federal, State, County or Municipal Government or by any other quasi-public or governmental agency upon or in respect of the wines warehoused under the terms of the agreement; (b) that the appellant agreed to render all reports required of the plaintiff or the corporation or of either of them in respect to the commodities warehoused by any and all governmental agencies; and (c) that at the option of the Warehouse Corporation it could pay all taxes, assessments, charges or penalties and could service, blend, fortify, rectify, handle and care for the warehoused wines and could render all reports at the expense of the appellant in the event the appellant failed to do so as agreed in the agreement;

B. Entered into a Field Warehouse Lease with Warehouse Corporation (Exhibit "H"; R. 19, 51) pursuant to the agreement contained in said Field Warehouse Storage Agreement (Exhibit "G"), and delivered the leased premises, adjacent to premises occupied by appellant, to the Warehouse Corporation, which corporation thereafter had sole and exclusive possession and control thereof (R. 19, 58);

C. Manufactured, fortified and removed to and stored in said Public Bonded Storeroom or Warehouse

all wines upon which the instant taxes were assessed and the interest and penalties paid thereon (R. 20, 59-60);

D. Serviced and cared for said wine, prepared and filed all returns required and paid all taxes (R. 29, 73) assessed upon the wine stored, as agreed with the Warehouse Corporation pursuant to and in accordance with the Warehouse Storage Agreement (Exhibit "G");

E. Requested the Warehouse Corporation, prior to the execution of said Collateral Agreement with the Bank (Exhibit "M1"), to issue Wine Warehouse Receipts, negotiable in form, to the Bank, or order, covering all of the above wine (R. 20, 59-60), some of which receipts,² negotiable in form, were issued and executed by the Warehouse Corporation prior to the execution of the Collateral Agreement by appellant with the Bank and the remainder thereafter, all in the name of and all of which receipts were delivered at the request of appellant to the Bank by the Warehouse Corporation (R. 20-21, 59-60); and,

F. Executed several promissory notes (for Form, see Exhibit "M") prepared by the Bank at the request and to the order of the Bank (R. 20-21); and thereafter, and prior to January 12, 1934, entered into a collateral agreement (for Form, see R. 64-70) with the Bank (R. 21, Exhibit "M1").

²All warehouse receipts issued were similar in form, with the exception of number, date, wine described therein and name of the Bank or Warehouse Corporation named therein (For form, see R. 60-62).

Subsequent to January 12, 1934 and the enactment of Section 10 (c) of the Liquor Taxing Act of 1934, appellant, pursuant to (R. 29-30) (a) A & C Mimeo. Coll. No. 4132 (Exhibit "O"), (b) Mimeo. Letter "Floor Tax on Distilled Spirits, Wines, etc." (Exhibit "P"), and in the belief that appellant was legally required,³ to do so, returned to defendant John V. Lewis an Inventory and Return on Form 756 (Exhibit "Q"), prepared and supplied by said defendant to appellant, showing a specific number of gallons of wine, containing a specified number of proof gallons of brandy on hand, upon which a tax was believed to be due in the amount stated (R. 29-30, 77).

Thereafter appellant paid (for Form of Receipt, see Exhibit "U") to said defendant John V. Lewis, as such Collector of Internal Revenue, the aggregate amount of the taxes assessed (R. 33) against appellant, and in addition the interest and penalties therein set forth in each action in the District Court (R. 30, 33, 80-81), pursuant to Notice and Demand (Exhibit "V") from said defendant therefor, and following assessment thereof, and after a protest (Exhibit "R") and a claim for abatement (for Form see Exhibits "S" and "T") of the tax had been denied (R. 31-32, 80-81).

A claim for the refund of the taxes, interest and penalties so paid to said defendant was filed there-

³See Exhibit "G", Field Warehouse Storage Agreement, wherein appellant contracted and agreed with the Warehouse Corporation to file all returns and pay all taxes assessed against the wine stored in the premises leased to the Warehouse Corporation.

after, which claim for refund was denied (R. 33, 81), whereupon the instant action was instituted to recover the taxes, interest and penalties so paid as aforesaid.

SPECIFICATION OF ERRORS.

The errors relied upon in this appeal are those set forth in the statement of points (R. 109-111) as follows:

1. Since all the evidence was contained in stipulations of fact, and there was no controversy as to the facts, in each of the respective cases consolidated in this appeal, only a question of law was presented to the trial Court.

2. The trial Court erred as a matter of law in holding that Section 10 (c) of the Liquor Taxing Act of 1934 levies an excise tax.

3. The trial Court erred as a matter of law in holding that Section 10 (c) of the Liquor Taxing Act of 1934 does not violate Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4 of the United States Constitution.

4. The trial Court erred as a matter of law in holding that Section 10 (c) of the Liquor Taxing Act of 1934, does not violate the Fifth Amendment to the Constitution of the United States.

5. The trial Court erred as a matter of law in holding that within the meaning of Section 10 (c) of the Liquor Taxing Act of 1934, 26 U. S. C. A. 451 (b),

1934 Cumulative Annual Pocket Part, the appellants held the specified quantities of wine set forth in the findings of fact, conclusions of law and respective judgments in each of the cases herein consolidated and appealed.

6. The trial Court erred as a matter of law in holding that the appellants intended to sell the wine so stored in bonded storerooms or use it in the manufacture or production of articles intended for sale.

7. The trial Court erred as a matter of law in holding that appellants and each of them, was subject to the provisions of said Liquor Taxing Act and was liable for an Internal Revenue Tax in the amount set forth in the findings of fact, conclusions of law and judgments entered in the respective cases before the United States District Court, herein consolidated and appealed.

8. The trial Court erred as a matter of law in holding that appellants and each of them was subject to and liable for the respective sums set forth in the findings of fact, conclusions of law and judgments in interest on the unpaid Internal Revenue taxes under the provisions of Section 10 (c) of the Liquor Taxing Act of 1934, U. S. C. A. 451 (b), 1934 Cumulative Annual Pocket Part.

9. The trial Court erred as a matter of law in holding that the respective sums of principal and interest set forth in the findings of fact, conclusions of law and judgments entered in each of the respective cases before the District Court of Appeals and con-

solidated in this case on appeal was rightfully and correctly paid and that appellants and each of them was not entitled to its return or any portion thereof.

10. The trial Court erred as a matter of law in holding that appellees John V. Lewis and the United States of America were entitled to a judgment of dismissal and for costs of suit incurred in said action.

As Specification of Errors numbered 2, 3 and 4 involve the same fundamental issues, as is true of Specification of Errors numbered 5 and 6, Errors 2, 3 and 4 will be discussed together and not separately, as will Errors 5 and 6, in the argument herein.

Likewise, as Specification of Errors numbered 7 to 10, inclusive, involve a determination, favorable to appellant, of one or more of Specification of Errors numbered 1 to 6, inclusive, the arguments applicable to Specification of Errors numbered 7 to 10, inclusive, will be considered in the argument relative to Specification of Errors numbered 1 to 6, inclusive, and not separately.

SUMMARY OF ARGUMENT.

I. Since all the facts were stipulated below and there was no controversy on the facts, the District Court had before it only questions of law. Likewise, only questions of law are before this Court.

II. The wines, upon which the taxes were assessed, levied and collected, were not "held" by any of the appellants herein on the taxable date, within the

meaning of Section 10 (c) of the Liquor Taxing Act of 1934, or at all, on January 12, 1934, the effective date of the Tax Act **(Specification of errors 5 to 10 inclusive)**.

III. Even if appellants “held” the wines, upon which the taxes were assessed, levied and collected, within the meaning of Section 10 (c) of the Liquor Taxing Act of 1934, on the effective date of said Tax Act, the assessment, levy and collection of the taxes thereon was a violation of certain provisions of the Constitution of the United States in that Section 10 (c) of said Liquor Taxing Act of 1934:

(a) Imposed a direct, rather than an excise tax, without proper apportionment among the several states according to population; and,

(b) Imposed a tax upon one class of persons only without equal protection of the laws **(Specification of errors 2, 3, 4, 7, 8, 9 and 10)**.

Consequently, as the wines were not “held” by appellants, as aforesaid, or, even if so “held” by appellants, within the meaning of Section 10 (c) collection of the taxes, interest and penalties from appellants was illegal and void on the constitutional grounds set forth.

ARGUMENT.

I.

ONLY A QUESTION OF LAW WAS PRESENTED
TO THE COURT BELOW.

As shown by the record, the only evidence before the trial Court was written stipulations of facts, there being no oral testimony. Accordingly, there was no controversy as to the facts, and the Court had before it only questions of law.

The District Court for the Southern District of New York, in *General Ribbon Mills, Inc. v. Higgins*, 32 Fed. Supp. 534, 537, said:

“Each case must be decided on its own state of facts. The facts being admitted whether they constitute ‘carrying on or doing business’ is a question of law.”

Likewise, this appeal presents only a question of law, free of confusion as to the facts. Whether appellants “held” the wine, upon which the taxes were imposed and collected, is a question of law for this Court to determine.

In a comparable situation, Mr. Justice Frankfurter said.

“What the activities of a taxpayer are is an issue for determination by triers of fact. Whether such activities constitute a ‘trade or business’ as conceived by Section 23 (a) of the Revenue Act of 1928, is open for determination here unfettered by findings and rulings below except for the weight of the intrinsic authority of all lower court opinions.”

Deputy v. Du Pont, 308 U. S. 488, 499.

In approaching this question, appellants respectfully submit that the benefit of any reasonable doubt should be given to them. Appellants' contention is not based upon any "exemption" provision of the law, but rather, on the one hand, that the law as passed by Congress does not include appellants within its scope. It is a familiar rule that tax laws are to be liberally construed in favor of taxpayers.

Burnet v. Niagara Falls Brewing Co., 282 U. S. 648, 654.

See also, *Miller v. Standard Nut Margarine Co.*, 284 U. S. 498, 508, where the Court said in part:

"It is elementary that tax laws are to be interpreted liberally in favor of taxpayers and that words defining things to be taxed may not be extended beyond their clear import. *Doubts must be resolved against the Government and in favor of the taxpayers*".

Moreover, revenue and tax statutes must be construed strictly.

U. S. v. Wigglesworth, 2 Story (U. S.) 369, 373;

Rice v. U. S., 53 Fed. 910;

Powers v. Barney, 5 Blatchf. (U. S.) 202, 203;

U. S. v. Watts, 1 Bond (U. S.) 580, 583;

U. S. v. Freed, 255 U. S. 257, 68 L. ed. 617;

Gould v. Gould, 245 U. S. 151;

Ebersole v. McGrath, 271 Fed. 995.

Nor are the provisions of laws imposing taxes to be extended by implication, which rule of law the District Court failed to follow in the instant matter.

Gould v. Gould, ante;

U. S. v. Field, 255 U. S. 257.

Where the language of a tax statute is ambiguous the Court adopts the construction which is most favorable to the taxpayer. Also, if there is any doubt as to the connotation of a term and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer.

Gould v. Gould, ante.

United States v. Merriam, 263 U. S. 179;

Old Colony R. Co. v. Commissioner;

Bowers v. Lighterage Co., 273 U. S. 346;

United States v. Updike, 281 U. S. 489;

Burnet v. Niagara Falls Brewing Co., ante.

Language used in tax statutes should be read in its ordinary and natural sense.

Helvering v. San Joaquin Co., 297 U. S. 496,
499;

Old Colony R. Co. v. Commissioner, ante.

Congress may well be supposed to have used language in accordance with the common understanding, and words in their known and ordinary signification.

Union Pacific R. Co. v. Hall, 91 U. S. 343, 347;

Old Colony R. Co. v. Commissioner, ante, 560.

The popular or received import of words furnishes the general rule for the interpretation of public laws.

Maillard v. Lawrence, 16 How. 251, 261;

Old Colony R. Co. v. Commissioner, ante;

Woolford Realty Co. v. Rose, 286 U. S. 319,
327;

United States v. Kirby Lumber Co., 284 U. S.
1, 3;

United States v. Buffalo Gas Fuel Co., 172 U. S. 339, 341;

Caminetti v. United States, 242 U. S. 470, 485;

U. S. v. First Nat. Bank, 234 U. S. 245, 258.

Doubt, if there can be any, is not likely to survive a consideration of the mischiefs certain to be engendered by any other ruling.

Woodford Realty Co. v. Rose, ante.

In the interpretation of tax statutes words should be "given their commonly accepted import". Congress may well be supposed to have used language in the popular sense according to common understanding and commercial designation.

United States v. Kirby Lumber Co., ante;

United States v. Buffalo Gas Fuel Co., ante, 341.

As was said in *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 370

"the plain, obvious and rational meaning of a statute, is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."

Old Colony R. Co. v. Commissioner, ante.

In seeking the intent of Congress the first consideration is the natural, ordinary and generally understood meaning of the term used.

United States v. Fisher, 2 Cr. 348;

Lake County v. Rollins, 130 U. S. 662;

Maillard v. Lawrence, ante;

United States v. Pacific Ry. Co., 91 U. S. 72.

The meaning of a statute must, in the first instance, be sought in the language in which it is framed, and if that is plain, and admits of no more than one meaning the sole function of the Courts is to enforce it according to its terms, as the duty of interpretation does not arise and the rules which are to aid doubtful meanings need no discussion.

Caminetti v. United States, ante;

Lake County v. Rollins, ante, 670, 671;

Hamilton v. Rathbone, 175 U. S. 414, 421.

It is the province of the Court to enforce, not to make the laws; hence the Court is not at liberty to amend the statute or read words into it to make it conform to what the Court may believe to be the spirit of the act or to escape the injustice of law.

Maxwell v. Moore, 22 How. 185;

United States v. Goldenberg, 168 U. S. 95;

Hobbs v. McLean, 117 U. S. 567;

St. Louis v. Taylor, 210 U. S. 281;

United States v. First Nat. Bank, ante, 245, 260;

Caminetti v. U. S., ante.

Where Congress has by apt terms created a class or drawn distinctions between classes of persons (i. e. distiller, producer, etc.) or objects, it is not competent for the Courts to extend or limit the operation of the statute.

United States v. Colorado Co., 157 Fed. 321;

United States v. Goldenberg, ante, 102;

Maxwell v. Moore, ante, 191;

Tiger v. Western Inv. Co., 221 U. S. 286.

A dispute over the meaning of a statute does not of itself show an ambiguity in the Act.

Nor. Pac. Ry. Co. v. Sanders, 47 Fed. 610;

Shreve v. Chusman, 69 Fed. 789;

Webber v. St. Paul City Ry. Co., 97 Fed. 140;

Swartz v. Siegel, 117 Fed. 13.

Subsequent experience is no guide to interpretation.

United States v. Un. Pac. Ry. Co., 91 U. S. 72;

Platt v. Pacific Ry. Co., 99 U. S. 48.

In practical effect, these cases are consolidated on appeal here before this Court for a determination *de novo*, and the decisions of the trial Court below are entitled to no presumption of correctness. The validity of the decisions below depends entirely upon the soundness of the *conclusions of law* drawn by the Court.

II.

THE WINES, UPON WHICH THE TAXES WERE ASSESSED, LEVIED AND COLLECTED, WERE NOT "HELD" BY APPELLANTS ON THE TAXABLE DATE WITHIN THE MEANING OF SECTION 10 (c) OF THE LIQUOR TAXING ACT OF 1934.

Section 10 (c) of the Liquor Taxing Act of 1934, 26 U. S. C. A. § 451 (b), 1934 Cumulative Annual Pocket Part, provides as follows:

"Sec. 10 (c). Upon all wines *held* by the *producer* thereof upon January 12, 1934, and *intended for sale or for use in the manufacture or production of any article intended for sale*, there shall be levied, assessed, collected, and paid a

floor tax equal to the amount, if any, by which the tax provided for under Section 443 of this title exceeds the tax paid upon the grape brandy or wine spirits used in the fortification of such wine.”

which Act by its expressed terms, became effective on the day following the enactment of said Act, namely January 12, 1934.

In view of the **Stipulations of Facts**, summarized by reference to said **Stipulation of Facts and Findings of Facts** in the **Statements of the Facts** herein (ante), a question of law only is presented as to whether appellants “held” the wines within the meaning of Section 10 (c) of the **Liquor Taxing Act of 1934**.

The District Court concluded in its opinion (R. 37, at 47) “ * * * that the liquor in question was ‘held’ * * * ” by appellants “ * * * within the meaning of Section 10 (c) on the effective date thereof,” in spite of the agreed statement of facts: that appellants did not, on said date, have either the physical possession or custody of the wines; that on said date the wines were not to be used further in the manufacture or production of any article intended for sale; that all wines were not to be used further in the manufacture or production of any article intended for sale; that all wines were in the physical possession of the warehouse corporation in its public bonded warehouse subject to the order of and the future sale by the Bank, as set forth in Uniform Warehouse Receipts, negotiable in form, issued in the name and to

the order of the Bank; and, that said Warehouse Receipts were in the name and in possession of said Bank on said date.

It should be noted in this connection, that the instant tax is imposed only "*upon wines 'held' by the producer thereof upon January 12, 1934*" and not upon wines "*held*" by any other person, including the Bank. Even then, the tax is not imposed upon every producer who "*held*" the wine on the taxable date, but only upon wines so held and *intended for sale or for use in the manufacture of any article intended for sale*.

Appellants contend that the wines, upon which the taxes were assessed, were not "*held*" by them under any accepted and general meaning of the word "*held*" on the taxable date, or under said Act.

What is the meaning of the word "*held*"?

"*Held*" means *owned*, in custody or in possession.

Taylor & Crate v. Asher, 223 Ky. 574, 4 S. W. (2d) 385;

Wey v. Salt Lake City, 35 Utah 504, 101 Pac. 381, 382;

Turner v. Horton, 18 Wyo. 281, 106 Pac. 688.

"As a technical term '*held*' embraces two ideas—that of actual possession of some subject of dominion or property, and that of being invested with legal title or right to hold or claim such possession."

"*Owned*" is the verb tense of "*own*", which means "To possess; to have or hold as property, appurtenance or proprium; to have rightful *title* to, whether

legal or natural; as, to own a house, a *title*, a prerogative.”

Webster's New International Dictionary, 1930 Edition.

An “owner” is defined by the same authority as “one who owns; a proprietor; one who has the *legal or rightful title, whether the possessor or not.*”

Stroud's Judicial Dictionary, Second Edition, Volume 2, states that “‘owner’ used in relation to goods, means, every person *who is for the time entitled, either as owner or agent for the owner, to the possession of goods.*”

“*Ownership*”, is defined by *Webster's New International Dictionary*, Second Edition, as “state, relation, or fact of being an owner; lawful claim or *title*; property; proprietorship; dominium.”

In fact the District Court below states (R. 45):

“The word ‘held’ implies *ownership*, *McFeely v. Commissioner*, 296 U. S. 102, 107; but does not always imply possession, *Ogle v. Helvering*, 77 F. (2d) 338, 339; *Commissioner v. Nevius*, 76 F. (2d) 109”.

Consequently, even the District Court agrees that the word “*held*” implies *ownership*. As above set forth, an “owner” is one who owns and who has the *legal or rightful title*, whether the possessor or not.

What better *legal or rightful title* could the Bank have than that evidenced by the negotiable warehouse receipts? In view of the California law, all that appellant could have possibly had on the taxable date,

under any stretch of the imagination or law, was an equitable right to have the title to the wine returned to appellant under *first*, an *understanding* when the warehouse receipts were issued, and *later*, under the *written* collateral agreement, executed thereafter, upon the happening of a condition subsequent, **which condition might never occur.**

In holding that "The *title* to the liquor was in plaintiff (appellant), the pledgor" (R. 46), the District Court concedes (R. 37) that if the *title* is in the Bank then appellants would be entitled to recover herein.

In view of the admitted facts and the law the District Court's conclusion (R. 45) that "Here the Bank, the holder of the receipt, could not *properly* demand plaintiff's (appellant's) wine from the warehouseman except under certain conditions set forth in the 'collateral *pledge* agreement' between the plaintiff (appellant) and the Bank", is amazing, to say the least; also, it is contrary to the law enunciated by this Circuit Court of Appeals, the Supreme Court of the United States, and the Supreme Court of the State of California, hereinafter set forth.

The logical conclusion to be drawn from the entire opinion of the District Court is that if the Bank, under the law, had the legal title and the right to demand the wine warehoused by appellant under the Warehouse Receipts issued in the Bank's name and delivered to the Bank, then appellants would have been entitled to recover the taxes, interest and penalties paid (R. 37).

That the Bank, rather than appellants, “*held*” the wine on the taxable date, and that the Bank alone, rather than appellants, had the legal title and the sole right on said date to the possession of said wines, is clearly established by the following authorities.

ANALYSIS OF LAW.

Origin of Section 10 (c).

Section 10 (a)⁴ of the Liquor Taxing Act of 1934 was a new section whereas Section 10 (c) was “borrowed” admittedly from the Liquor laws in force in 1918.

Prior to 1918, and until 1933, it was customary for a producer of wine to finance his operations by the issuance of promissory notes secured by the wines in his possession. At that time it was found necessary to establish a more satisfactory method of financing the production of wines in order to insure payment of the notes by unimpaired retention of the security.

Accordingly, on September 16, 1933, pursuant to repeated requests from California wine producers and financiers, Treasury Decision No. 19 (Exhibit “A”) was promulgated. Under this decision Public Bonded Storerooms were authorized to be established and to issue warehouse receipts covering commodities stored therein.

⁴Section 10 (a) of the Liquor Taxing Act of 1934 imposed a floor tax upon *every person* who “held” distilled spirits, intended for sale or for use in the manufacture of any article intended for sale on the taxable date.

According to officials of the Treasury Department, they had expected wine producers, under this plan, to have warehouse receipts issued in their own names and then hypothecate these receipts with the financing agency. Treasury Department officials did not foresee the present situation wherein the title to the wines stored was transferred immediately, upon storage in the warehouse, to the financing agency by means of negotiable warehouse receipts. However, transfer of title to the wines was not prohibited under existing Treasury Decisions, Rules or Regulations.

In the construction of statutes, prior acts may be cited to solve, but not to create an ambiguity.

Hamilton v. Rathbone, ante.

Hence, the repeated reenactment of a statute without substantial change may amount to an implied legislative approval of a construction placed upon it by executive officers.

National Lead Co. v. United States, 252 U. S. 150;

United States v. Farrar, 281 U. S. 624;

Poe v. Seaborn, 282 U. S. 101, 116;

Old Colony R. Co. v. Commissioner, ante, 557.

Intention of Congress must be clearly expressed.

Unless Congress has definitely indicated an intention that the words should be construed otherwise, we must apply them according to their usual acceptation.

Avery v. Commissioner, 292 U. S. 210, 214.

Had Congress intended the Liquor Taxing Act to apply to one having a right under a contract or an

“equity” in the wine for *tax purposes* it would have been a simple matter so to state. Failing to do so it is apparent Congress had no intention to do so.

Maass v. Higgins, 61 S. Ct. 631, 312 U. S. 413,
85 L. Ed. 940, 132 A. L. R. 1035;

United States v. Field, ante, 264;

U. S. v. First National Bank, 234 U. S. 245,
262;

U. S. v. Penn. Co., 1917, 239 Fed. 741.

Moreover, even if Congress so intended, failure to include in the Act the holder of such contract or “equity” right to have title to the wine transferred to him upon certain conditions, prevents a valid imposition upon him of the tax, because tax statutes must be strictly construed.

Estate of Childs; Dwight v. Riley; 18 Cal. (2d)
237, 115 P. (2d) 432.

Had Congress intended to tax such a contract right or “equity”, if any existed in the wine, it would have been a simple matter to have so stated but none was expressed in the act under consideration, hence such right or “equity” must be excluded from the tax.

United States v. Field, ante.

The provisions of laws imposing taxes are not to be extended by implication.

Gould v. Gould, ante;

United States v. Field, ante.

It would require language so clear as to leave room for no other reasonable construction in order to induce the belief that Congress intended Section 10 (c) of the Liquor Taxing Act to apply to persons other

than those who "held" the wine in the generally accepted meaning of the term "held".

United States v. Wurts, 303 U. S. 414, 418;

United States v. First National Bank, ante, 258.

What law governs.

The laws of the several states, except where the Constitution, treaties or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law in the Courts of the United States, in cases where they apply.

Title 28, *U. S. Code Annotated*, Section 725;

Taney v. Penn. Nat. Bank of Reading (Pa.

1911) 187 F. 691, 109 C. C. A. 437, affirming

(D. C. 1910) 176 F. 606 and affirmed (1914),

345 S. Ct. 288, 232 U. S. 174, 58 L. ed. 558.

The legal effect and validity of all transactions, leases, agreements, warehouse receipts, contracts or documents, in the instant case, are local and not Federal questions, and depend upon and must be construed and determined in accordance with the laws of the State of California.

Etheridge v. Sperry, 139 U. S. 266, 277;

Taney v. Penn Bank, ante, 180;

Thompson v. Fairbanks, 196 U. S. 516;

Humphrey v. Tatman, 198 U. S. 91;

York Manufacturing Co. v. Cassell, 201 U. S. 344;

Hiscock v. Varick Bank, 206 U. S. 28;

Security Warehousing Co. v. Hand, 206 U. S. 415, 425;

Bryant v. Swofford Bros., 214 U. S. 279.

Interpretation and validity of contracts between plaintiff, warehouseman and Bank.

The language of a contract governs its interpretation.

California Civil Code, Section 1638.

The law and usage of the place where the contract is made governs the contract.

California Civil Code, Sections 1646, 1656.

The object of a contract must be lawful when made.

California Civil Code, Section 1596.

All of the necessary elements of a valid contract are present in connection with all documents executed in the instant case.

California Civil Code, Sections 1550, 1580, 1614, 1667.

Warehouse Receipts Act governs transactions.

Issuance of the warehouse receipts was authorized by the California law.

Warehouse Receipts Act 9039, enacted in 1909, as amended, *Deering's General Laws*, Vol. 3, p. 4975, Sec. 1, Statutes 1909, p. 4673;

Vol. 3, Deering's General Laws, Act 9058, pp. 4974, 4975;

California Civil Code, Secs. 1858-1858f, inc.; *California Agricultural Code*, Secs. 1231, et seq.;

Heffron v. Bank of America, N. T. & S. A., (C. C. A. 9th) 113 Fed. (2d) 239, 242.

Warehouse Receipts Act repealed all acts or parts of acts under statutes and laws of California, inconsistent therewith.

Warehouse Receipts Act, ante, Section 60.

The Warehouse Receipts Act of California was intended to achieve uniformity and to effect the secure and ready use of warehouse receipts as instruments of credit. This purpose is inconsistent with the notion that the business world must look to something other than the observance of the definite and comprehensive statements of the Warehouse Receipts Act itself.

Heffron v. Bank of America, N. T. & S. A.,
ante.

Consequently, warehouse receipts must be distinguished from notes, chattel mortgages, trust receipts, pledges and other types of legal obligations.

Commercial Discount Co. v. Los Angeles County, 100 Cal. Dec. 239.

In this connection, the Court, in *Pattison v. Dale*, 234 U. S. 399 (345 Sup. Ct. 785, 58 L. ed. 1370, 52 L. R. A. (n. s.) 754), at page 405, states:

“It is insisted that this clearly and unmistakably establishes the doctrine that any transaction designed to give a security in personal property, if not accompanied by an actual change of possession, must be placed in the form of a chattel mortgage and filed for record, in order to be good as against creditors. It seems to us, however, that we should not fail to consider the well-recognized distinction between a chattel mortgage and a pledge. A mortgage of chattels

imports a present conveyance of the legal title, subject to defeasance upon performance of an express condition subsequent, contained either in the same or in a separate instrument. It may or may not be accomplished by delivery of possession. On the other hand, where title to the property is not presently transferred, but possession only is given with power to sell upon default in the performance of a condition, the transaction is a pledge, and not a mortgage.”

In the instant case, under the above decision, as the possession of the wines, as well as the title thereto, was transferred to others, there cannot be a chattel mortgage of the property in question; nor could there be a pledge thereof, the opinion of the District Court to the contrary notwithstanding, in favor of the Bank. The United States Supreme Court, in the above case at page 404, states further:

“The legal effect of such a transaction depends upon the local law”.

Several cases, decided by the Supreme Court of the State of Ohio, are referred to and quotations made therefrom, in the above case, covering the legal effect of a warehouse receipt. In particular, the Court, in this case, refers to the case of *Gibson v. Stevens*, 8 How. 384, 12 L. ed. 1123, in which connection the Court said, at page 408:

“The citation of *Gibson v. Stevens* is significant, because in that case this Court in an opinion by Mr. Chief Justice Taney, recognized that where personal property is, from its character or situation, not capable of actual delivery, delivery

of a warehouse receipt or other evidence of title is sufficient to transfer the property and right of possession to another; and also, because this decision was based in large part upon the usages of trade and commerce."

In *Dale v. Pattison*, ante, the Court concluded that the Warehouse Receipts had the effect of transferring from Rohrer to Pattison, the legal title and right to possession of the property covered thereby, for the purposes of the agreement between them.

In considering the legal effect of the issuance of warehouse receipts, negotiable in form, under the laws of the State of Pennsylvania, by a warehouseman who was also the producer of the distilled spirits covered by the warehouse receipts, as between the trustee in bankruptcy of the warehouseman and the Bank to whom warehouse receipts were endorsed and delivered, and which Bank held the receipts under a pledge agreement, the United States Supreme Court in the case of *Taney v. Penn. Nat. Bank*, 232 U. S. 174, 58 L. ed. 558, held that the legal effect of the transaction depended upon the local law; also, among other things, that physical delivery of the property covered by the warehouse receipt, is not essential, in Pennsylvania, to effect a transfer of title and possession to whiskey stored in a bonded distillery warehouse, accompanied by the issuance, conformably to trade usage, of warehouse receipts, negotiable in form, representing such whiskey, which, though stored in the company's own warehouse, is under the control of the Federal Government, and cannot be removed without payment of the internal revenue tax.

In *Central State Bank v. M'Farlin*, 1919, (C. C. A. 8 Cir.), 257 Fed. 535, it was held that the endorsement of warehouse receipts or certificates for grain to a Bank as security, transferred to the Bank the legal title to the grain represented thereby. In that case, certain negotiable warehouse certificates were endorsed by the holder to the Bank as collateral security to certain promissory notes made by the endorser to the Bank. This case quotes, as authorities for its decision, the *Gibson v. Stevens* and *Dale v. Pattison*, cases, cited ante.

Accordingly, under the above decisions, the legal title to the wines stored in the warehouse was in the Bank on the taxable date, regardless of any collateral or other agreements between the parties, the opinion of the District Court below to the contrary notwithstanding.

Warehousing on premises of merchant proposing to pledge his merchandise is effective when done in obedience with legal requirements, and it is immaterial that purpose of warehousing is to enable merchant to finance himself on security of goods by use of warehouse receipts.

Heffron v. Bank of America, N. T. & S. A.,
ante, p. 242.

The Bank, not plaintiff, was the owner of and entitled to possession of wine taxed.

The warehouse receipts issued herein were and are negotiable.

Warehouse Receipts Act, ante, Section 5;
California Civil Code, Section 1858 b.

Issuance of the warehouse receipts herein to the Bank operated to transfer to the Bank such title as plaintiff had or had the ability to convey to a purchaser in good faith for value.

Warehouse Receipts Act, ante, Sections 41, 42;
California Civil Code, Section 1858 b;

Heffron v. Bank of America, N. T. & S. A.,
 ante;

Union Trust Co. v. Wilson, 1905, 198 U. S. 530.

And the Bank or holder of the warehouse receipt is entitled to the immediate possession of the goods represented by the receipt, and the warehouseman is legally bound to deliver the goods upon a demand made by the Bank or the holder of the receipt.

Warehouse Receipts Act, ante, Section 8;

Cavallaro v. Texas etc. Ry. Co., 110 Cal. 348,
 359;

Ex Parte Benjamin Harris & Co., 141 S. C.
 430, 140 S. E. 101, 50 A. L. R. 1109.

A Warehouse Receipt is *prima facie* evidence of ownership of the merchandise covered thereby.

Akron Cereal Co. v. First National Bank, 3
 Cal. App. 198.

Possession of personal property (i. e. wine or warehouse receipts) is *prima facie* evidence of ownership.

Akron Cereal Co. v. First National Bank, ante.

A holder for value of a negotiable warehouse receipt issued in his name or endorsed to him in conformity with the Uniform Warehouse Receipts Act is the owner of the goods represented thereby.

Taney v. Penn. Natl. Bank of Reading, ante;
Shepardson v. Carey, 29 Wisconsin 42.

The placing of property in a room leased to, and kept by, a vendee, pledgee, or warehouseman, accompanied by a continuous display of signs and placards plainly indicating the vendee's, pledgee's or warehouseman's interest, constitute a sufficient change of possession to make the transaction valid.

Hatch v. Standard Oil Co., 100 U. S. 124;

Sumner v. Hamlet, 12 Pick 76;

Union Trust Company v. Wilson, ante;

Heffron v. Bank of America, N. T. & S. A.,
ante.

And such possession by the warehousemen is a real and not a constructive possession of the goods deposited.

Humphrey v. Tatman, ante.

Thompson v. Fairbanks, ante.

The issuance of a warehouse receipt in the name of the Bank and the delivery thereof to the Bank was a real and not merely a symbolic delivery of the wine to the Bank.

Union Trust Co. v. Wilson, ante.

Consequently, appellant could not set up any right to defeat the pledge of the property by the warehouse company to the Bank, in the ordinary course of business, under the Warehouse Receipts Act of California.

California Civil Code, Section 2991.

Transfer of a warehouse receipt, in good faith and in the ordinary course of business to the Bank operated to transfer title to the goods covered by the receipt, and transferee acquired not only all rights

of transferor but also the direct obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt, as fully as if warehouseman had contracted directly with him, free of equities between warehouseman and original bailor.

Davis v. Russell, 52 Cal. 611; 28 Am. St. Rep. 647;

Boas v. De Pue Warehouse Co., 69 Cal. App. 246, 249;

See *Warehouses*, 27 R. C. L. 966, Sections 22-27 incl.

Moreover the conveyance or transfer of property was in consideration of a pre-existing indebtedness, hence is a conveyance for a valuable consideration.

Davis v. Russell, ante;

Virginia Etc. Co. v. Glenwood Lumber Co., 5 Cal. App. 256, 261;

Breeze v. International Banking Corp., 25 Cal. App. 437, 450;

Sackett v. Johnson, 54 Cal. 107, 109.

Even creditors of the appellant could not subject the wine in the possession of the warehouse to attachment or execution.

McCullough v. Large, 20 Fed. 309;

Heffron v. Bank of America, N. T. & S. A., ante;

Sinsheimer v. Whitely, 111 Cal. 378, 43 Pac. 1109, 52 Am. St. Rep. 192.

The warehouse had the wine under lock and key in a place to which it had a legal title and right of

access by lease and the right to exclude others; hence had possession of the wine in the fullest sense.

Union Trust Company v. Wilson, ante.

Transactions in good faith and free of fraud.

Under the contract between plaintiff and the Bank, the Bank was given the right not only to take title and deliver the warehouse receipts to its own name, but likewise the right was given to the Bank to transfer unconditionally the wine covered by the warehouse receipts to any person. See Exhibit "M1".

Hiscock v. Varick Bank, ante.

Consequently, insofar as appellees are entitled to be concerned, as there was no bad faith or fraud, it is immaterial whether the transactions between appellant, the Bank and the warehouse company was a pledge, or a secured transaction, or a sale because the Bank exercised the right given to it under the collateral agreement by taking warehouse receipts in its own name as owner thereof.

Security Warehouse Co. v. Hand, ante.

Legal effect of negotiable warehouse receipts issued.

The warehouseman is legally required and bound to deliver the goods covered by the negotiable warehouse receipt upon demand to the holder of the receipt.

Warehouse Receipts Act, ante, Section 8.

Transfer of a negotiable receipt operates to transfer title to the goods covered thereby.

Civil Code of California, 1858 b;

Davis v. Russell, ante.

Endorsement of a negotiable warehouse receipt by the party to whose order it is issued passes the absolute title to the property mentioned thereon to the endorsee.

Bishop v. Fulkerth, 68 Cal. 607.

Even the possession of a negotiable warehouse receipt, indorsed in blank or delivered without indorsement is presumptive evidence of ownership of the goods, *Davis v. Russell*, ante; and such presumption is not rebutted by a showing that the property was originally purchased by the defendants where the receipt, given to their agent in his own name, was afterwards found in the possession of plaintiffs.

Horr v. Barker, 8 Cal. 609.

Ownership of property is established by a warehouse receipt and, hence, presumption that right to present possession followed as a necessary sequence.

Garoutte v. Williamson, 108 Cal. 135.

The party to whom a note is made payable is *prima facie* the owner.

Price v. Dunlap, 5 Cal. 493, 19 Cal. Jur. 1043.

The owner of the wine (the Bank) and the warehouse is, in point of law, in possession of the wine, *U. S. v. Thirty Six Barrels High Wines*, (C. C. N. Y. 1870), 7 Blatchf. 459, 28 Fed. Cas. No. 16,468; and the holder of the warehouse receipt is the owner of the property.

Merchants National Bank v. Roxbury Distilling Co., 196 Fed. 76.

Even mere assignments of warehouse receipts for advances made against goods as security therefor

transfers not only the legal title but also the constructive possession of the property;

Gibson v. Stevens, 8 How. 384, 12 L. ed. 1123;

Dale v. Pattison, ante.

Even under the general law in the absence of statute.

Central State Bank v. M'Farlin, ante;

See also: *Taney v. Penn. Nat. Bank of Reading*, ante.

With the delivery of the receipts to the Bank such delivery of the documentary evidence of title, is held to be a constructive delivery of the goods.

Storey on Sales, Section 311;

Storey on Contracts, Sections 792, 810.

The delivery of bonded warehouse receipts is sufficient to complete a sale of intoxicating liquors without manual delivery of the liquor.

Smuylan v. U. S., (C. C. Ohio, 1923), 293 F. 283.

Treasury decision 19 repealed in part.

Upon the ratification of the 21st amendment to the United States Constitution, the 18th amendment thereto at once became inoperative. Neither the Congress nor the Courts could give it validity. The National Prohibition Act, to the extent that the provisions rested upon the grant of authority to the Congress by the 18th amendment, immediately fell with the withdrawal by the people of the essential constitutional support. Consequently, the requirement

contained in Treasury Decision 19 for incorporation in warehouse receipts of restrictive provisions became inoperative on December 5, 1933, with the ratification of the 21st amendment to the United States Constitution.

United States v. Chambers, 1934, 54 S. Ct. 434, 294 U. S. 217;

Liquor Control Law Service, Federal 2nd Ed., Commerce Clearing House Inc. paragraph IV, Section .02, page 226; Liquor Law Repeal and Enforcement Act, Title I, Section 1, 49 Statute 872.

Bank held title on taxable date.

Moreover, the Bank was authorized to hold Warehouse Receipts, negotiable in form, and title thereunder on the taxable date. Section 30 of the *1931 Regulations 2, United States Treasury Department*, reads as follows:

“Sec. 30. *Warehouse certificates*.—Warehouse certificates covering distilled spirits in Government bonded warehouses may be sold and purchased without the necessity of obtaining permits under these regulations and without involving the seller in special tax liability as a liquor dealer under the internal revenue laws. Ownership of such certificates confers the right of possession in Government bonded warehouses of the distilled spirits covered thereby, but does not confer the right to remove such distilled spirits from bond except for non-beverage purposes under the procedure prescribed in these regulations.”

Even appellees admitted in their "Defendants' Closing Brief" filed in the District Court (Page 4, Lines 4-9) that "Insofar as the rights of creditors are concerned that is, bona fide creditors, it must be admitted that the banks did take *title* to the wine. *That has been admitted before* but as between the plaintiffs and purchasers the banks held title to the wine only as security and they held the bare legal *title*."

Nevertheless, in spite of this frank admission, the District Court below held that the *title* to the liquor was in appellant, without any reservations whatever.

In view of the decision of the United States Supreme Court in *Pattison v. Dale*, ante, and other cases cited, the further conclusion of the District Court below that plaintiff (appellant) was the *pledgor* of the liquor is erroneous and contrary to the facts and the law, because only the title and not the possession of the so-called "*pledged*" property was delivered to the Bank.

Under the above decisions, were it not for the California Uniform Warehouse Receipts Act, this transaction would have been a mortgage of chattels, because under a pledge only the physical property and not the title is delivered to the pledgee, with a power of sale in the event of the occurrence of a condition subsequent. Here the Bank had the title but not the possession of the property. But the Bank did have in addition the *present* right of possession under the negotiable warehouse receipts. Only *if* and when, *if* at all, appellants paid their obligations to

the Banks before the wine was sold or the Warehouse Receipts were negotiated could appellants have had any right or claim to have the wine sold and returned to them. Hence, contrary to the conclusion of the District Court below (R. 46) appellant, had no right on the taxable date, to sue and assert a *title* that appellant did not possess on said date and had no right to possess on said date.

In fact, Section 19 of the *Warehouse Receipts Act*, ante, provides that no right or title of a third person shall be a defense to an action brought by the depositor or a person claiming under him against the warehouseman for failure to deliver the goods according to the terms of the receipt to the Bank.

Here again, the District Court cites, in support of its "*conclusion*" Section 3008 of the *California Civil Code*, which relates solely to *pledges*, and not negotiable Warehouse Receipts, and which Code Section was adopted in 1872, and repealed, to the extent applicable thereunder, by the *California Uniform Warehouse Receipts Act*, adopted in 1909. Likewise, the District Court cites the case of *Akron Cereal Co. v. First National Bank*, 3 Cal. App. 198, 201-2, to support its "*conclusion*" that "The warehouse receipt is only *prima facie* evidence of ownership" (R. 46), which case was denied in 1906, upon a state of facts that arose in 1900, some nine years before the California Uniform Warehouse Receipts Act changed this rule of law as then enunciated by that Court. Moreover, it appears therein that the warehouse receipts were non-negotiable in form and had been de-

posited as security for a loan as a pledge, whereupon the court made the statement quoted in an action for conversion instituted by the real owner.

Under a state of facts, in *Heffron v. Bank of America, N. T. & S. A.*, ante, similar to the instant cases, except that the Warehouse Receipts issued were non-negotiable, rather than negotiable as herein, this Court, speaking through Circuit Judge Healy, states, in part:

“As said in the McCaffey case, supra, ‘warehousing on the premises of the owner proposing to pledge his merchandise is effective when done in obedience to legal requirements.’ It is immaterial that the purpose of the warehousing is to enable the merchant to finance himself on the security of his goods by the use of warehouse receipts. Such is the primary and legitimate objective of modern field warehousing. *Union Trust Co. v. Wilson*, supra.

(2) The California Warehouse Receipts Act, Deering’s General Laws, 1937, Act 9059, enacted in 1909 and several times amended, expressly repeals all acts or parts of acts in conflict with it. We are satisfied that this statute exclusively governs the decision to be made here.

The act defines a warehouseman as ‘a person lawfully engaged in the business of storing goods for profit,’ section 58, and provides that ‘warehouse receipts may be issued by any warehouseman.’ Section 1. Non-negotiable as well as negotiable receipts are recognized and protected. The act imposes upon the warehouseman the obligation to deliver the goods to the holder of the warehouse receipts, and he is made liable as

for conversion in case of misdelivery and for damages caused by the non-existence of the goods.

As a condition to the validity and effectiveness of the receipts, the act does not in terms or by implication require notice to be given of the warehousing of the commodities they represent. Nor is notice to creditors of the bailor made a pre-requisite of the issuance, negotiation or transfer of receipts. The act provides (§ 25) that in the case of goods delivered to the warehouseman by the owner, and for which a negotiable receipt is issued, the goods cannot be attached or otherwise levied upon while in the possession of the warehouseman, unless the receipt be first surrendered or its negotiation enjoined.

Of immediate signification here is §42, providing that a person to whom a receipt has been transferred but not negotiated, acquires thereby, as against the transferor, the title to the goods, subject to the terms of any agreement with the transferor'. By notifying the warehouseman of the transfer to him of a non-negotiable receipt,³ the holder acquires the direct obligation of the warehouseman to hold possession of the goods for him according to the terms of the receipt. 'Prior to the notification of the warehouseman by the transferor or transferee of a non-negotiable receipt, the title of the transferee to the goods and the right to acquire the obligation of the warehouseman may be defeated by the levy

³Here the Warehouse Company was fully informed of the transfer of the receipts, and all pledged goods in the warehouse were marked to indicate that the receipts were in the hands of the Bank."

of an attachment or execution upon the goods by a creditor of the transferor * * * '”.

“ * * * The statute does more than fix the rights of the holders of warehouse receipts; it circumscribes as well the rights of creditors. In effect it denies to creditors essential rights conferred by the bulk sales law.

The right is unconditionally bestowed on the owner of warehoused goods to convey or pledge his title by a transfer of the warehouse receipt.”

“ * * * Indeed, the general scheme of the Warehouse Receipts Act to achieve uniformity, and to effect the secure and ready use of warehouse receipts as instruments of credit, is inconsistent with the notion that the business world must look to something other than the observance of the definite and comprehensive terms of the act itself. Compare *Jewett v. City Transfer & Storage Co.*, 128 Cal. App. 556, 18 P. (2d) 351.

We conclude that the Warehouse Receipts Act repealed § 3440 so far as the latter might otherwise apply to warehoused goods.”

Even in the case of a conditional sales contract, which differs from a pledge and a chattel mortgage, for reasons herein indicated, and from the warehouse receipt, negotiable in form, because, in the former case, a mere security title only is retained and the possession of the commodity is delivered to the vendee, whereas, in the latter case, title and the right to immediate possession is in the holder of the warehouse receipt, the Court, in the case of *Earle C.*

Anthony, Inc. vs. United States, 57 Ct. Claims, 259, decided that an automobile was not *held* by the vendor *and intended for sale* so as to permit a tax exemption authorized under a tax statute, where the vendee had given to the vendor twelve installment notes in payment, in spite of a reservation of title in the vendor under the contract and a concluding paragraph of the tax statutes exempting articles sold where title is reserved as security. **In the instant case, appellant had not performed that part of the agreement with the Bank on the taxable date that would have authorized appellant to institute an action against the Bank for the recovery of the Warehouse Receipts or the property represented thereby.**

Consequently, appellants contend: that title to the wine, covered by the warehouse receipts issued in the name of and delivered to the Bank prior to the execution of the collateral agreement, referred to by the District Court as the "collateral pledge agreement" (R. 45), was conveyed to and was "held" by the Bank prior to and on the taxable date; that this was true also as to the wine covered by the warehouse receipts issued in the name of and delivered to the Bank after the execution of the collateral agreement; that appellants, on said taxable date, neither owned nor "held" the title, possession, or right to possession of said wine within the meaning of Section 10 (c) of the Liquor Taxing Act of 1934, or at all; that on said taxable date appellants could not have maintained a suit to recover said wine unless they had first paid all sums due the Bank, which had not been done; that

on said taxable date the wine was not held by appellants as a *producer* thereof nor was *it intended for sale or for use in the manufacture of any article intended for sale*, or at all, by appellants; that the only interest or equity that appellants had in said wine was the agreement contained in the collateral agreement to have any surplus proceeds turned over to appellants by the Bank, under their respective agreements, after the sale of the wine by the bank and payment of all expenses in the event of the failure of appellants to pay the Bank all sums due under said agreement by any outstanding note or agreement, and then only in the event the Bank had not already sold the wine as authorized under the agreement; that said warehouse receipts were not transferred to the Bank pursuant to the authority contained in paragraph three of the collateral agreement (R. 66), rather, they were issued, in many cases before the said agreement was even signed, at the request of appellants by the Warehouse Corporation and delivered by said Corporation to the Bank; that, as the word "held" means ownership and title to the wine, the Bank and not appellants "held" the wine on the taxable date, regardless of any rights that may have existed otherwise in favor of appellants, under the collateral agreement on the taxable date.

III

EVEN IF APPELLANTS "HELD" THE WINE ON THE TAXABLE DATE, THE COLLECTION OF THE TAXES THEREON WAS ILLEGAL AND VOID BECAUSE IN VIOLATION OF THE PROVISIONS OF THE CONSTITUTION OF THE UNITED STATES OF AMERICA.

Unlike a true excise tax, which imposes a tax upon the doing of an act, Section 10 (c) of the Liquor Taxing Act of 1934, ante, imposed a tax merely upon a *supposed or assumed intention* to do something that might never be done. Therefore, there is presented to this court the new question as to whether Congress has the power to impose, as an "*excise*", without apportionment, among the several states, of a tax based upon an "*intention*" to do something in the present or in the future, which intention is frequently unknown, or cannot be ascertained, and may never come to pass.

Appellants contend, that because Section 10 (c) of the Liquor Taxing Act of 1934 seeks to impose a tax upon a mere "*intention*", rather than upon the doing of an act, that this Section is in violation of Article I, Section 9, Clause 4, of the United States Constitution, in that it levies a *direct* tax upon the property itself; also, is in violation of Article I, Section 2, Clause 3, of the Constitution of the United States, in that the tax is not "apportioned among the several states which may be included within this Union, according to their respective numbers"; and, because said Section 10 (c) is in violation of the Fifth Amendment of the Constitution of the United States of America, in that it seeks to impose a tax upon one

class of persons only, namely, a particular type and kind of producer of wines, hence, such Act deprives such persons of the equal protection of the laws under the due process clause of the United States Constitution.

Even in the case of *McGoldrick v. Gulf Oil Corporation*, 309 U. S. 430, 84 L. ed. 849, it is to be noted that in exceptional cases, and then only in cases coming from the Federal Courts, this Court can consider questions such as that urged, that the instant tax violates the 5th Amendment of the United States Constitution, by the appellant, and not pressed or passed upon in the Courts below.

Distinction between excise and direct taxes.

Numerous instances of taxes held to be valid excise taxes are available. However, it will be noticed that in all of these cases the tax is imposed upon a particular act or privilege sought to be exercised or done.

In *Knowlton v. Moore*, 1899, 178 U. S. 41, Mr. Justice White, in upholding as a valid excise a tax on legacies and distributive shares under a will, observed the apparent confusion that exists in determining whether a tax is an *excise* or *direct* tax.

On page 77, of this decision, he states:

“Indeed, the confusion which gives rise to both of the constructions of the statute which we have considered, comes from the want of insight pointed out by Hanson in a passage which we have heretofore quoted; that is, it arises from not keeping in mind the distinction between a

tax on the interest to which some person succeeds on a death, and a tax on the interest which ceased by reason of the death, the two being different objects of taxation”.

On page 47, he says:

“Taxes of this character are universally deemed to relate, not to property *eo nomine*, but to its passage by will or by descent in cases of intestacy, as distinguished from taxes imposed upon property, real or personal, as such, because of its ownership and possession. In other words, the public contribution which death duties exact, is predicated on the passage of property as the result of death, as distinct from a tax on property disassociated from its transmission on receipt by will, or as the result of intestacy”. Continuing, Justice White says: “Direct taxes bear immediately upon persons, upon the possession and enjoyment of rights; indirect taxes are levied upon the happening of an event or an exchange”.

On page 49, the Court quotes from *Hanson’s Death Duties* at page 63:

“What it takes is not the interest to which some person succeeds on a death, but the interest which ceased by reason of the death.”

On pages 52 and 53 the Court considers the legal effect of *Pollock v. Farmers’ Loan & Trust Company*, 157 U. S. 429, and on rehearing 158 U. S. 601, because included in the income upon which the tax therein considered alleged to be unconstitutional, was “money and the value of all personal property acquired by gift or inheritance.”

The Court concludes that on the first hearing:

“ * * * it was decided that, to the extent that the income taxes included the rentals from real estate, the tax was a direct tax on the real estate, and was therefore unconstitutional, because not apportioned. Upon the question of whether the unconstitutionality of the tax on income from real estate rendered it legally impossible to enforce all the other taxes provided by the statute, the Court was equally divided in opinion. *Ib.* 586. On a rehearing (158 U. S. 601) the previous opinion was adhered to, and it was moreover decided that the tax on income from personal property was likewise direct, and that the law imposing such tax was therefore void because not providing for apportionment”.

Quoting from page 637 of that decision the court concluded, in substance, from the language used, that the inclusion in income of property acquired by gift or inheritance, (the passing of which could be taxed separately) became invalid because included in one scheme of taxation, the greater part of which was unconstitutional, from which such gift and inheritance property could not be divided.

It is interesting to note that under other revenue statutes, unlike Section 10 (c) of the Liquor Taxing Act of 1934, the tax imposed therein only becomes due when the wine is sold or removed for consumption or sale;

Revenue Act of 1918, Section 611;

Revenue Act of 1918, Section 613;

Internal Revenue Code, Section 3030;

(a) (1) (A), *Act of June 24, 1940*, (Public No. 655, 76th Congress).

or when *used* in the fortification of wine;

Revenue Act of 1918, Section 615;

Act of June 24, 1940, ante, Section 3, amending Section 3031 (a) Internal Revenue Code; *Treasury Decision* No. 4994, page 7, Regulations paragraph 309.

or upon *withdrawal* of the wine;

Act of June 24, 1940, ante, Section 3, amending Section 3031 (a) Internal Revenue Code.

and no wine can be *produced* or *received*, and no brandy *withdrawn* for fortification until a proper bond is filed and notice and bond approved;

Title 26, *Code of Federal Regulations*, par. 48 as amended. See also *Treasury Decisions* No. 4994, p. 5.

Also, upon the manufacturing and refining of sugar, *Spreckels Sugar Refining Co. v. McLane*, 48 L. Ed. 496; Upon the manufacture of cheese, *Cornell v. Coyne*, 484 L. Ed. 504; Upon doing business in a corporate capacity, *Flint v. Stone Tracy Co.*, 55 L. Ed. 389; Preparation of tobacco for sale, *Patton v. Brady*, ante; Upon the passing of property; and, upon other uses of property.

As is pointed out in *Pollock v. Farmer's Loan and Trust Company*, 1895, 157 U. S. 429, in the case of *Hylton v. The United States*, (also referred to in *Springer v. United States*, 1880, 102 U. S. 586, hold-

ing a tax on slaves a direct tax) the question whether the tax on carriages was direct or indirect was disputed, but the tax was sustained as a tax on the *use* of the carriages, hence a valid excise tax.

In the case of *Patton v. Brady*, 184 U. S. 608, an "in lieu" tax was enacted increasing an earlier tax imposed upon the manufacture and sale of tobacco, which tax did not become *due* until the manufacture or sale of the tobacco. Hence, the floor tax under consideration in that case increasing a tax not yet *due and payable*, which became *effective* prior to the sale for consumption of the tobacco, in effect was an excise tax upon the doing of an *act* namely, the *sale* for consumption thereafter, although applicable to tobacco then "*held and intended for sale.*"

Obviously, this case differs from the instant cases because in the instant cases the tax became *due* forthwith and neither the obligation to pay the tax nor its payment was conditioned upon the doing or the right to do a subsequent *act*.

That this tax was and is a *direct tax* is indicated in *Pollock v. Farmers Loan and Trust Company*, ante. There, it is pointed out that the prima facie definition of direct taxes is that ordinarily all taxes paid primarily by persons who can shift the burden upon someone else, or who are under no legal compulsion to pay them, are considered indirect taxes; but a tax upon property holders in respect of their estates, and the payment of which cannot be avoided, are *direct taxes*.

Under Section 10 (c) of the Liquor Taxing Act of 1934, the producer could not shift the burden of the floor tax to another because the tax was *due* forthwith from *him* although payable later; hence, the producer was under a legal compulsion to pay any tax so due.

As the tax imposed was upon a particular property holder only, (i. e. the producer) upon a specific kind of property or estate only, (i. e. brandy in wine “intended for sale”) and which tax could not be avoided, such a tax must, perforce, be a *direct* tax. Not having been apportioned, under the United States Constitution, according to the population, the tax is *void*.

A tax imposed upon the *right to do an act* has been upheld as a valid excise tax, even though it conferred no right to carry on a business if forbidden to be engaged in by the State.

License Tax Cases, 5 Wall. 462.

In *Dawson v. Kentucky Distilleries*, 255 U. S. 288, it was held that a tax upon one of the essential incidents of property is a tax upon property. There an annual license tax upon persons engaged in the business of owning and storing whiskey in bonded warehouses was held to be a tax upon property and not uniform in its operation, even though disguised as an *excise* tax upon the “business” of withdrawing liquor from warehouses.

At page 292, Mr. Justice Brandeis says:

“The name by which a tax is described in the statute is, of course, immaterial. Its character

must be determined by its incidents; and obviously it has none of the ordinary incidents of an occupation tax.”

In the instant cases, as in the *Dawson* case, ante, the tax in question has none of the ordinary incidents of an excise tax. It was neither a tax imposed upon the doing of an act nor a tax upon the right to engage in a business. By express language, the tax was upon specific property, namely, upon all wines held by a certain kind of a producer on a date certain.

Thus far, appellant has been unable to find any tax imposed, other than the instant one, upon a particular group of a class. Rather, excise taxes are imposed upon every *person* doing an act or exercising a privilege that is not basically incident to ownership of property.

Under the *Act of June 24, 1940*, (Public No. 655, 76th Congress) effective July 1, 1940, Section 3030 (a) (1) (A), Internal Revenue Code, the tax “upon all wines” is imposed, as under the statute considered in the *Patton v. Brady* case “when sold or removed for consumption or sale”.

Likewise, under the same Act, Section 3031 (a) provides for a credit “whenever brandy or wine spirits shall be lawfully *used* in the fortification of wines”, and for assessment of the tax against the producer of wines who has *withdrawn* brandy or wine spirits for *use* in the fortification of wines.

Moreover, “no wine may be *produced* or *received* and no brandy *withdrawn* for fortification until a proper bond is filed and the notice and bond are approved by the district supervisor.”

Paragraph 48, Part 178, Title 26, *Code of Federal Regulations*; also see: *Treasury Decisions* 4994, page 5.

Bromley v. McCaughn, 1929, 280 U. S. 124, supports the contention of appellants, despite the fact that there was a strong dissent by Justices Sutherland, Butler and Van Devanter.

In this case a graduated tax “upon the transfer by a resident by gift” of any property during the calendar year was upheld as a valid excise tax.

As the right to transfer by gift is a privilege and the tax was imposed only when the right was exercised, it is conceded that it was a valid excise tax.

Mr. Justice Stone, at page 136, in delivering the majority opinion covering the various cases on “direct taxes”, says, in part:

“that a tax imposed upon a particular *use* of property or the exercise of a single power over property incidental to ownership, is an excise which need not be apportioned * * * ”.

“It is a tax laid upon the exercise of a single one of those powers incident to ownership, the power to give the property to another. Under this statute all the other rights and powers which collectively constitute property or ownership may be enjoyed free of the tax.”

After considering certain excise tax cases, Mr. Justice Stone says, on page 137, in part:

“It is true that in each of these cases the tax was imposed upon the exercise of one of the numerous rights of property, but each is clearly distinguishable from a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his property.”

“It is said that since property is the sum of all rights and powers incident to ownership, if an unapportioned tax on the exercise of any of them is upheld, the distinction between direct and other classes of taxes may be wiped out, since the property itself may likewise be taxed by resort to the expedient of levying numerous taxes upon its uses; that one of the uses of property is to keep it, and that a tax upon the possession or keeping of property is no different than a tax upon the property itself. Even if we assume that a tax levied upon all the uses to which property may be put, or the exercise of a single power indispensable to the enjoyment of all others over it, would be in effect a tax upon property, see *Dawson v. Kentucky Distilleries Warehouse Co.*, 255 U. S. 288, and hence a direct tax requiring apportionment, that is not the case before us.”

Yet, in the instant cases, appellees would have the Court believe that the tax in question was a valid excise tax in spite of the fact that the tax is not upon a use but is imposed upon an owner (*held*) regardless of any use or disposition made of his property.

Other cases have held: (1) that a tax upon the amount of sales made by an auctioneer upon goods sold was void, *Cook v. Pennsylvania*, 97 U. S. 566; (2) that a tax on the sale of an article, imported only for sale, is a tax on the article itself, *Brown v. Maryland*, 12 Wheat. 419; and (3) that a tax on income derived from real or personal property is a tax on the property itself, *Pollock v. Farmers Loan & Trust Company*, ante.

Yet, in *Nicol v. Ames*, 173 U. S. 509, it was said that a tax levied upon a sale of property effected at a board of trade or exchange was an excise laid upon the privilege, opportunity or facility afforded by boards of trade or exchanges for the transaction of the business and not upon the property or the sale thereof, which, would be a direct tax and void without apportionment.

As is pointed out by Mr. Justice Day, in *Buchanan v. Warley*, 1917, 245 U. S. 60, at p. 74,

“Property is more than the mere thing which a person owns. It is elementary that it includes the right to acquire, use, and dispose of it. The Constitution protects these essential attributes of property. *Holden v. Hardy*, 169 U. S. 366, 391. Property consists of the free use, enjoyment and disposal of a person’s acquisition without control or diminution save by the law of the land. 1 Blackstone’s Commentaries.”

Even as the power to tax is the power to destroy, to uphold a tax as an excise which imposes a tax, not upon a use as such, but merely upon a use es-

sential to ownership, would be to uphold a *direct* tax on the property itself.

Counsel for appellants, after reading opposing briefs submitted in the case of *Commonwealth of Pennsylvania v. Fix*, 9 Fed. Supp. 272, can, upon the authority of the same case on appeal, as *Commonwealth of Pennsylvania ex rel. Margrotti v. Kyle*, 79 F. (2d) 520 (certiorari denied by Supreme Court, 297 U. S. 704), state positively that the District Court decision is at best poor dictum, and is not applicable authority herein in support of the conclusion of the District Court below (R. 43).

Not only the facts, but also the legal issues involved and raised, are different therein from the instant cases.

As is clearly pointed out therein by the Circuit Court of Appeals, the only issue involved was whether a taxpayer could enjoin the collection of a federal tax, in the absence of a showing that unless enjoined irreparable damage would result to the taxpayer. Upon the authority of cases cited it was held that collection of the tax could not be enjoined.

It is significant that neither the Circuit Court of Appeals nor the Supreme Court on certiorari considered the question erroneously raised by the District Court as to the validity of the taxes sought to be collected.

A Pennsylvania State Court granted an injunction at the instance of the State of Pennsylvania against

the collection from it as the operator of State liquor stores of certain federal license, floor and other liquor taxes. Thereafter the action was removed to the Federal District Court, and entitled *Commonwealth of Pennsylvania v. Fix*, ante, with the result noted above denying the right of injunction.

In the District Court Pennsylvania contended, in addition to the right to enjoin the collection of the taxes: (1) that in the operation of the liquor stores it was engaged in a governmental, as distinguished from a proprietary, function; and (2) that the floor taxes sought to be collected are unconstitutional and void in that they are direct taxes which have not been apportioned among the several states in the manner required by the Constitution of the United States.

Both of these latter contentions were decided against the State of Pennsylvania for reasons therein set forth.

However, as to the second point above, that the taxes were direct taxes unapportioned as required by the Constitution, the State of Pennsylvania did not distinguish between Sections 10 (a) and 10 (c) of the Liquor Taxing Act of 1934, as do appellants in the instant cases, that Section 10 (c) is special legislation and Section 10 (a) general legislation, nor did the State raise the point that it was not a *producer* of the wines held by it for sale on the taxable date, or that for the reasons set forth by appellants Section 10 (c) was and is a *direct* rather than an *excise* tax.

Moreover, the State *held* the wine on the taxable date whereas in the instant cases the wine was *held* legally by the Bank and the warehouse company.

In the instant case the tax was imposed (Section 10 (c) of the Liquor Taxing Act of 1934):

“Upon all wines held by the producer thereof upon the day this title takes effect and intended for sale or for use in the manufacture of any article intended for sale, there shall be levied, assessed, collected and paid a floor tax equal to the amount, if any, by which the tax provided for under Section 8 of this title exceeds the tax paid upon the grape brandy or wine spirits used in the fortification of such wine”;

Under the above Section, the floor tax imposed was due immediately, but the date of payment of the tax could be extended to a date not exceeding seven months after the effective date of the Act.

Such was not true in *Patton v. Brady*, ante.

The floor tax imposed in the *Patton v. Brady* case was conditioned upon the doing of a prior act, i. e. *a sale*, and did not become due until the *sale* occurred.

In that case an earlier statute imposed a tax of six cents per pound “upon tobacco and snuff *manufactured and sold*, or *removed* for consumption or use.”

Thereafter Congress increased this tax to twelve cents per pound “ * * * however *prepared, manufactured and sold*, for consumption or sale * * * ” and further provided,

“ * * * there shall also be assessed and collected, * * * upon all articles enumerated in

this section which were manufactured, imported and removed * * * before passage of this Act * * * , and which articles were at the time of the passage of this act held and intended for sale by *any person*, a tax equal to the difference between the tax already paid on such articles at the time of *removal* from the factory or customhouse and the tax levied upon such articles.”

Obviously, both taxes were valid *excises* because their imposition was conditioned upon the doing of acts, to wit: *Preparation, manufacture, sale and removal* of the articles upon which the tax was imposed.

Consequently, when the taxpayer *sold* goods, previously removed upon which the tax was paid for removal, after the effective date of the Act, such Act on his part became a taxable transaction, the amount of the tax therefor being determined by the amount of goods removed and sold.

In the instant cases the tax was not imposed upon “*any person*” but only upon a “*producer*” and then only on a particular kind of a producer, i. e. who *held* the wine on the taxable date. The tax imposed became due immediately without any act being done at all. All that the imposition of the tax depended upon was, apparently, that the wine *was intended for sale or for use in* the manufacture of an article intended for sale on the effective date of the Act. On that date one *producer* could say he did not intend to sell or use the wine and another could say he did.

The producer could merely change his unexpressed intention and thereby exempt the brandy in the wine

from the new floor tax because even if he held the wine and did not intend to sell or use it in the manufacture of another article intended for sale, the brandy in the wine became tax free.

Certainly, a tax must be definite, certain and uniform in its operation in order to be valid.

Moreover, all *persons*, who held the same kind of wine manufactured out of similar commodities and under similar conditions, were not obliged to pay the so-called "equalizing floor tax".

The attention of this Court is directed to the fact that in all of the cases cited, the "*excise*" tax is imposed upon the doing of an act, the happening of some event, or upon the exercise of a right to do a certain act; whereas in the present case the tax is upon *wine held by the producer and "intended" for sale or for use in the manufacture of an article intended for sale*, rather than upon the doing of an act, the happening of an event, or the exercise of a right to do an act.

Congress has, under this statute, stretched the already elastic construction of an *excise* tax to include a new field, namely, the taxing of property, *if* the owner of property has an "intent" to do anything at all with it. **If the tax were upon the wine, and that portion of the Liquor Taxing Act of 1934, relating to the intent to sell, were omitted, it is apparent, under the authority of *Pollock v. Farmers Loan & Trust Company*, ante, that this would be a direct tax upon personal property.** In the *Pollock* case,

the Court pointed out that it has consistently held, almost from the foundation of the government, that a tax imposed upon the particular use of property, or the exercise of a single power over property incidental to ownership, is an *excise* tax, which need not be apportioned. However, where the tax was imposed upon the income of the property, the receipt of which was a basic incident of ownership of the property itself, such a tax was held to be a direct tax, which must be apportioned.

The question therefore resolves itself into the inquiry as to whether Congress, by adding to what would otherwise be a direct tax upon the wine itself, the further and additional element of an intent to do something with the property, which intent may never be realized or consummated, can convert the direct tax into an excise tax. Appellants contend that Congress has the power to exercise only those powers delegated to it expressly under the Constitution of the United States, and, that it cannot do indirectly that which it is prohibited from doing directly, namely, imposing, ostensibly as an excise tax, a tax which is in reality a direct tax upon the property itself, because the right to have an "*intention*" to do something with property is an incident to the ownership of the property, as distinguished from doing something with the property.

Inasmuch as appellees concede, in their closing brief filed in the District Court below on page 21, lines 8 to 11 inclusive, that "if the tax imposed by Section 10 (c) were a direct tax then it admittedly

would have to be apportioned, admittedly it was not apportioned, and therefore would be unconstitutional'', appellants do not deem it necessary to submit further authorities in this connection at this time.

CONCLUSION.

On the basis of the facts, which are undisputed, and the decisions determining the legal provisions in question, as well as the common sense of the situation, appellants submit that the decision and judgment of the trial court was erroneous in the particulars noted in the Specification of Errors and should be reversed and remanded to the District Court, with instructions to enter Findings of Fact and Conclusions of Law in accordance with the agreed statement of facts and the law governing the issues involved, issuing thereafter a judgment in conformity therewith, and a certificate of probable cause in those cases in which the United States of America has been properly dismissed as a party defendant.

Dated, San Francisco,
October 19, 1942.

Respectfully submitted,

ROBERT H. FOUKE,

Attorney for Appellants.

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MOUNT TIVY WINERY, INC. (a corporation), *Appellant*,
vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California
District, and UNITED STATES OF AMERICA, *Appellees*.

CALIFORNIA WINERIES AND DISTILLERIES, INC. (a corporation),
vs. *Appellant*,

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FRESNO WINERY, INC. (a corporation), *Appellant*,
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ST. GEORGE WINERY (a corporation), *Appellant*,
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On Appeals from the District Court of the United States
for the Northern District of California.

BRIEF FOR APPELLEES.

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No. 10,220

IN THE

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On Appeals from the District Court of the United States
for the Northern District of California.

BRIEF FOR APPELLEES.

OPINION BELOW.

The opinion of the District Court (R. 37-47) is reported at 42 F. Supp. 636.

JURISDICTION.

The appeal¹ in *Mount Tivy Winery v. Lewis* is taken from a judgment of the District Court entered April 3, 1942 (R. 85-86), in favor of the appellee in an action filed on August 28, 1938 (R. 2-10), pursuant to the provisions of Section 24, Fifth, of the Judicial Code, for the refund of \$15,419.33 assessed and paid as taxes imposed on wine held by a producer under Section 10(c) of the Liquor Taxing Act of 1934. A claim for refund was filed on August 28, 1935 (R. 33) within four years after date of payment and was rejected by the Commissioner of Internal Revenue on July 29, 1936. (R. 33.) The notice of appeal was filed on July 3, 1942 (R. 90-93), pursuant to Section 128(a) of the Judicial Code, as amended.

QUESTIONS PRESENTED.

1. Whether the taxpayer, the producer of the wine here involved, held such wine on January 12, 1934, within the meaning of Section 10(c) of the Liquor

¹Upon stipulation of the parties (R. 94-97), and order of the District Court (R. 98), the appeals in the other six cases have been consolidated for all purposes with the *Mount Tivy Winery* case and are to be governed by the decision in that case. The judgments of the District Court in these other cases, as well as notices of appeals, were filed on the same dates as in the *Mount Tivy Winery* case, and these cases meet all of the jurisdictional requirements.

Taxing Act of 1934 and so is liable for the tax imposed by such section.

2. Whether the tax imposed by Section 10(c) of the Liquor Taxing Act of 1934 is a valid excise tax, as the District Court held, or whether it is unconstitutional, as the taxpayer claims.

STATUTE AND OTHER AUTHORITIES INVOLVED.

The pertinent statute and other authorities involved are set forth in the Appendix, *infra*, pp. i-iv.

STATEMENT.

The facts as found by the District Court in *Mount Tivy Winery v. Lewis*² may be summarized as follows (R. 48-81):

This is an action against a former Collector of Internal Revenue to recover \$15,419.33 in taxes and interest alleged to have been erroneously collected. The taxpayer is a California corporation, with its principal place of business at Fresno, California. It is engaged in the manufacture, production and sale of wine intended for sale or use in the manufacture of articles intended for sale in Bonded Winery No. 3620 at Lac-Jac, Fresno County, California. (R. 48-49.)

²As the facts in all seven cases are very similar and as it has been stipulated by the parties that these cases, which have been consolidated for all purposes, will be controlled by the decision in the *Mount Tivy Winery* case, the facts in the other cases have not been given in the record. (R. 94-98.)

On November 13, 1933, the taxpayer and the Fidelity Warehouse Corporation executed a "Field Warehouse Storage Agreement", which provided among other things that the Fidelity Warehouse Corporation should furnish the taxpayer all field warehouse services necessary to the taxpayer's business and that the taxpayer should employ the Fidelity Warehouse Corporation for all field warehouse services required by the taxpayer and further, that the taxpayer would furnish warehouse premises owned or controlled by the taxpayer in which field warehousing was to be conducted. Specifically, the Fidelity Warehouse Corporation agreed among other things (1) to maintain a public warehouse in and upon premises leased by the taxpayer to the corporation; (2) to furnish to the taxpayer all field warehouse services necessary to the taxpayer's business; (3) to place a bonded agent and/or bonded watchman in charge of the warehouse and leased premises; and (4) to issue field warehouse receipts upon the property which the taxpayer might store therein. The agreement also provided (1) that the Fidelity Warehouse Corporation should be free from all liability for taxes or penalties levied, assessed by a federal or any other governmental or quasi-public agency in respect to the wines warehoused under the terms of the agreement; (2) that the taxpayer agreed to render all required reports in respect to the commodities warehoused by any and all governmental agencies; and (3) that at the option of the Fidelity Warehouse Corporation it could pay all taxes, penalties, and could service, blend, fortify, rectify, handle and care for the warehoused wines and could render

all reports at the expense of the taxpayer in the event the taxpayer failed to do so as agreed in the agreement. (R. 49-51.)

On the same date, the taxpayer executed a Field Warehouse Lease, pursuant to the provisions of the Field Warehouse Storage Agreement and as authorized by Treasury Decision 19. This leased to the Fidelity Warehouse Corporation a portion of a building and all containers therein for use as a warehouse. The building so leased was adjacent to the same premises as taxpayer's Bonded Winery No. 3620, bore the same postoffice box number and was contiguous with and adjoining the structures of taxpayer's Bonded Winery No. 3620. (R. 51.)

On November 25, 1933, the Fidelity Warehouse Corporation secured a permit to establish and operate Public Bonded Storeroom No. 3728 in the leased premises. (R. 51, 58.) Such permit was issued pursuant to the federal and state laws and the regulations thereunder, particularly Treasury Decision 19 and General Circular No. 141, approved September 16, 1933.³ This circular announced amendments to the regulation, which provided (1) that all proprietors of bonded wineries must secure permits in order to operate, but field warehouses could be established by others than winemakers for the storage of wine for credit purposes, when in the Commissioner's judgment such warehouses were warranted; (2) that anyone advanc-

³These were introduced as Exhibit A, attached to the stipulation (R. 16, 34), and are not included in the record, but copies have been transmitted to this Court pursuant to a stipulation of the parties (R. 100-102; for excerpts, see also R. 52-57).

ing credit on the security of the wine stored in the warehouse could dispose of such wine, upon foreclosure, only to a permit holder; (3) that warehouse receipts covering the wine were only transferable to a permit holder; and (4) that warehouse receipts must state the above provisions in (1) and (2) on their face. (R. 52-53.) An opinion of the Attorney General held that such provisions were valid. (R. 54-57.)

The leased premises were taken over by the Fidelity Warehouse Corporation, and a bonded agent was placed in charge and given printed instructions as to his duties. The warehouse agreement and lease were executed prior to the passage of Section 10(c) of the Liquor Taxing Act of 1934, here involved, and were not executed in contemplation of such statutory provision. (R. 59.)

During the months of November and December, 1933, and before January 12, 1934, taxpayer removed 484,000 gallons of fortified wines from Bonded Winery No. 3620 and stored it in Public Bonded Storeroom No. 3728, and in writing requested the Fidelity Warehouse Corporation to issue four original wine warehouse receipts negotiable in form, for a total of 484,000 gallons of wine to the Bank of America National Trust & Savings Association, Fresno Branch, or order (hereinafter referred to as the Bank) as follows: One for 211,000 gallons dated November 29, 1933, numbered 01304; the second for 123,000 gallons dated December 4, 1933, numbered 01307; the third for 119,000 gallons dated December 22, 1933, numbered 01312; and the fourth for 31,000 gallons dated January 6, 1934, num-

bered 01316; which receipts were issued and executed in the name of and were delivered at the request of the taxpayer on those dates to the Bank by the Fidelity Warehouse Corporation. (R. 59-60.)

The warehouse receipts were marked negotiable and stated that the Fidelity Warehouse Corporation had received for storage from the Mount Tivy Winery, deliverable to the Bank or order, the property described therein, subject to the conditions contained therein and the payment of storage and other charges. (R. 60.) The receipt also provided (R. 61, 62) :

This Fidelity Warehouse Company warehouse receipt is issued pursuant to permit No. P-18, issued by the Bureau of Industrial Alcohol, United States Treasury Department, in accordance with section 704 of the Regulations 2 and Paragraph 9 of Regulations 7, as amended, which authorized the issuance of this warehouse receipt.⁴

* * *

These goods will be delivered upon surrender of this receipt, properly endorsed, and the payment of all charges and liabilities due the undersigned warehouseman.

The Wine Covered by This Warehouse Receipt Cannot Be Possessed, or Used in any Manner or Disposed of or Transferred Except to a Bona Fide Permittee of the Bureau of Industrial Alcohol.

⁴These regulations provided for field warehouses, such as the one here, for credit purposes (R. 52-53), and Permit No. P-18, which is Exhibit C herein, authorized the Fidelity Warehouse Corporation to establish and operate a bonded storeroom "for credit purposes", as provided in such regulations.

The 484,000 gallons of fortified wine deposited with the Fidelity Warehouse Corporation evidenced by the warehouse receipts and stored in the warehouse on January 12, 1934, had been produced by the taxpayer at its Bonded Winery No. 3620 prior to January 11, 1934, and contained 147,927.08 proof gallons of brandy previously withdrawn from a distillery and previously used in the fortification of the wine produced by the taxpayer. Prior to January 11, 1934, and at the time of the withdrawal and use of the brandy in fortifying the wine there had been assessed against the taxpayer a tax of 10 cents per proof gallon as required by the Revenue Act of 1918, as amended. (R. 62.)

On January 12, 1934, the taxpayer had in its Bonded Winery No. 3620, 220,297.34 gallons of fortified wine. This wine had likewise been produced by the taxpayer in its winery and contained 61,863.88 proof gallons of brandy which had also previously been withdrawn from a distillery for the fortification of the wine produced by the taxpayer and upon this brandy taxpayer had been assessed a tax at the rate of 10 cents per proof gallon as required by the Internal Revenue Act of 1918, as amended. The taxpayer made no claim for the abatement or refund of the tax assessed by the Collector of Internal Revenue on this wine, and the taxpayer does not seek to recover that tax in this action. (R. 63.)

Upon receipt of the wine from the taxpayer, the warehouse company placed it in storage tanks located upon the leased premises and caused to be placed upon the tanks in which the wine was stored, stock cards

showing that the wine was warehoused to the Bank, the description of the wine, the date of the warehousing, the negotiable warehouse receipt number issued against the wine and the quantity and quality of the wine stored therein. (R. 63.)

In accordance with the provisions of the Field Warehouse Storage Agreement and in accordance with an understanding between the taxpayer and the Fidelity Warehouse Corporation, the taxpayer was from time to time permitted to have access to the bonded storeroom for the purpose of servicing and caring for the wine during the period the wine was stored in the bonded storeroom. (R. 63-64.)

All the wine except as otherwise specified herein was in the physical possession and under the physical control of the Fidelity Warehouse Corporation and was held by it as a bonded warehouseman in its Public Bonded Storeroom No. 3728 under the laws of California, and the United States, and the rules and regulations of the Treasury Department, including Treasury Decision 19 and the agreements between it and the taxpayer, between the taxpayer and the Bank and between it and the Bank. (R. 64.)

Prior to the actual issuance of the warehouse receipts, the Bank from time to time extended unsecured bank credits to the taxpayer. As wine was produced and delivered by the taxpayer to the warehouse company, the warehouse company issued the warehouse receipts described above covering the wine. These warehouse receipts were delivered to the Bank. At the request of the Bank, the taxpayer executed several

promissory notes payable to the Bank and executed a collateral agreement with the Bank, which provided that in consideration of the financial accommodations given to Mount Tivy Winery by the Bank and as collateral security for the indebtedness of the winery, it would assign to, and deposit with, the Bank all property delivered by it then or later. As to such property, the agreement stated that the Mount Tivy Winery was the owner and that such property was stored, deposited and cared for at the risk of the winery. It was further stated that the Bank was given power to transfer to its own name as pledgee or trustee any certificates of stock, warehouse receipts, etc., which might be deposited with it as security, that it could sell any property so deposited upon default of the winery and that any excess should go to the winery. (R. 64-70.)

The 484,000 gallons of fortified wine thus delivered to the warehouse company for storage in Public Bonded Storeroom No. 3728 by the taxpayer prior to January 11, 1934, were produced and intended for sale and were subsequently sold in the following manner: The taxpayer secured a prospective purchaser for the wine and notified the Bank of the proposed terms of the sale. In the event the purchaser and the terms of sale were satisfactory to the Bank, the sale was consummated with the approval of the Bank upon a cash or credit basis. As a part of the same general sales transaction, the Bank would then execute and deliver to the Fidelity Warehouse Corporation an order for warehouse release covering the wine sold to the purchaser. The warehouse receipts were then either de-

livered to the warehouse company for cancellation or for endorsement thereon of the amount of the wine sold or for the issuance of a new warehouse receipt, negotiable in form, in the name of and to the order of the Bank for the remaining unsold quantity of wine covered by the warehouse receipt and the redelivery to the Bank of the cancelled, endorsed or new receipt or the Bank would deliver both the order for warehouse release and the warehouse receipt to the purchaser or the warehouse company subject to the purchaser's further order or endorsement. Subject to the order of the purchaser, wine sold to it was thereafter prepared for shipment to the purchaser or its order on the warehouse premises by the taxpayer and the warehouse corporation made an entry on Form 702, a report filed monthly with the Collector by the warehouse company, indicating the release of the wine to the taxpayer and the wine was received by the taxpayer for the purposes mentioned for the account of the purchaser and subject to the order of the purchaser. (R. 71-72.)

The warehouse receipts were in the possession and control of the Bank at all times except when surrendered to the warehouse company for the release of wine. None of the receipts were ever endorsed or negotiated by it. Prior to January 12, 1934, the taxpayer had not defaulted upon its notes nor had any of the other conditions set forth in the collateral pledge agreement under which the Bank could properly demand the wine from the warehouseman matured nor had the Bank disposed of them or of the wine under

any of the powers conferred upon it by the collateral pledge agreement. (R. 72.)

The Bank did not pay personal property taxes or any taxes imposed by the Liquor Taxing Act of 1934 upon the wine covered by the warehouse receipts. All taxes on the wine were paid by the taxpayer in accordance with and pursuant to the agreement with the warehouse corporation. (R. 73.)

In accordance with instructions from the Commissioner of Internal Revenue, the Collector sent the taxpayer a circular on January 15, 1934, which referred to the Liquor Taxing Act of 1934, and required it to submit a list of all wines and other spirits on hand, calling special attention to the fact that the winery should list separately all goods not on the premises but held by the taxpayer and stored elsewhere. (R. 73-77.)

The taxpayer sent in an inventory of wine in its possession as producer and held by it for sale in the use or manufacture of articles intended for sale. (R. 77.) This inventory (R. 78-79) showed that the taxpayer held 660,470.97 gallons of wine, containing 194,963.16 proof gallons of brandy upon which a tax was believed to be due of \$19,496.32 (R. 80).

On February 10, 1934, the taxpayer paid the Collector of Internal Revenue \$2,000 and subsequently wrote the latter a letter in which it stated that the \$2,000 represented a tax liability on brandy in fortified wine in the hands of the taxpayer and that the remaining balance of \$17,496.32 represented the tax on the brandy in the fortified wine held by the Fidelity Warehouse Company. As to the latter, the taxpayer asserted

that the Fidelity Warehouse Company held full possession and control of the wine and brandy as a bailee or warehouseman for the Bank of America, and so it protested the payment of any tax assessed or levied against the wine or brandy held by the Fidelity Warehouse Corporation. (R. 80.)

On April 11, 1934, the Commissioner of Internal Revenue assessed taxes in the amount of \$19,496.32 against the taxpayer and on November 10, 1934, rejected claims in abatement of \$17,496.32 in taxes. On August 28, 1935, the taxpayer filed a claim for the refund of \$15,419.33, which claim for refund was also rejected. The taxpayer then filed the complaint in this action on July 28, 1938, and thereafter served the United States Attorney on January 30, 1939, and served the Attorney General of the United States on February 28, 1939. The service on the United States Attorney and the Attorney General of the United States were made more than two years after the date of the mailing of the notice of rejection of the claim for refund by the Commissioner of Internal Revenue. (R. 80-81.)

The District Court concluded as a matter of law (1) that while it did not have jurisdiction of the action against the United States, it did have jurisdiction of the action against the defendant John V. Lewis; (2) that Section 10(c) of the Liquor Taxing Act of 1934 levies an excise tax and does not violate Article I, Section 2, Clause 3, or Article I, Section 9, Clause 4 of the Constitution; (3) that such section does not violate the Fifth Amendment to the Constitution; (4) that the

taxpayer was the producer of the 484,000 gallons of fortified wine stored with the Fidelity Warehouse Corporation on January 12, 1934, held such wine within the meaning of Section 10(c) of the Liquor Taxing Act, and also intended to sell such wine within the meaning of that section; (5) that the taxpayer was liable under Section 10(c) for tax in the amount of \$14,792.71 on 484,000 gallons of fortified wine, and also liable for \$1,558.53 in interest; (6) that the taxpayer is not entitled to recover any sum paid and (7) that John V. Lewis is entitled to a judgment of dismissal with costs. (R. 82-84.)

SUMMARY OF ARGUMENT.

The District Court properly denied any refund here inasmuch as the taxpayer comes within the statutory provision imposing a tax on wine held by the producer and intended for sale or use in the manufacture of any article intended for sale. In common understanding "to hold" means to own property, and the taxpayer was the owner here in the sense that ownership is popularly understood and is interpreted in tax law. It is not material that the wine was not in the physical possession of the taxpayer on the critical date or that negotiable warehouse receipts covering such wine had been issued to a bank. The evidence shows that the receipts were delivered to the Bank pursuant to an agreement which gave the terms of loans made by the Bank to the taxpayer and indicated that such receipts were being transferred as a pledge, not as a result of

a sale to the Bank. Thus, the Bank held the receipts merely as security for these loans and could claim the wine only in case of default, but as there was no default, it never had a right to take the wine from the warehouse. By all of their actions, the parties showed that the taxpayer was considered the real owner, and this should be the view in this case. In administering tax laws, courts have not favored a view of ownership which is highly technical or imposes refinements of title, and the District Court is in accord with such decisions.

The tax here involved does not violate any provision of the Constitution or the amendments thereto. It is not a direct tax on property but is a tax on a particular use of property. Therefore, it is an excise tax specifically authorized by the Constitution and is similar to many others which have been sustained by the courts. Accordingly, there is no basis for the taxpayer's objection that the tax here is invalid.

ARGUMENT.

I.

WINES PRODUCED AND FORTIFIED BY THE TAXPAYER AND STORED IN THE WAREHOUSES WERE HELD AND INTENDED FOR SALE WITHIN THE MEANING OF SECTION 10(c) OF THE LIQUOR TAXING ACT OF 1934 AND ARE SUBJECT TO THE TAX IMPOSED BY THAT SECTION.

On January 12, 1934, the effective date of the Liquor Taxing Act of 1934, the wine in the warehouses had been fortified with brandy upon which there had been

paid or assessed a tax at the rate of ten cents per proof gallon. (R. 24.) See also Section 612 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, as amended by Section 452 of the Revenue Act of 1928, c. 852, 45 Stat. 791. Section 8 of the 1934 Act raised the tax on brandy used in the fortification of wine after January 12, 1934, to twenty cents per proof gallon. Section 10(c), Appendix, *infra*, imposed upon all wines held by the producer on January 12 and intended for sale or for use in the manufacture or production of any article intended for sale a floor stock tax equal to the amount, if any, by which the tax provided for in Section 8 exceeds the tax paid upon the brandy used in the fortification of the wine. The obvious purpose of the statute was to prevent wine stored in bonded store-rooms or warehouses throughout the nation from entering the field of commerce at the old tax rate, thus avoiding the increased tax and securing an advantage over wine fortified subsequent to the passage of the 1934 Act.

Clearly, therefore, in referring to wines "held" by the producer on January 12 and intended for sale, Congress had in mind wine which had not been sold or removed from the bonded warehouses for consumption or sale, and the word "held" was not used in any narrow sense. To argue, as does the taxpayer, that the wine here involved was not "held" by it merely because the warehouse had possession of the wine and the Bank had warehouse receipts for the wine is to disregard entirely the purpose of the tax and the nature of the credit transaction with the Bank.

The word "held" is not a word of art and its meaning depends on the statute in which it is used. In this case, however, the word "held" may be given its known and ordinary meaning (*Old Colony R. Co. v. Commissioner*, 284 U.S. 552, 560), and the taxpayer will nevertheless come within the scope of the statute. "To hold" (present tense of "held") is commonly defined as "to maintain possession or authority over" and also as "to own or possess". See Webster's New International Dictionary. From these definitions, it is apparent that holding may refer either to possession or ownership. For instance, an owner turning over his property to a bailee, an agent, or a lessee, but still having control and dominion over the property and also the right to recover possession upon meeting certain conditions is generally considered as still holding the property, regardless of who has actual possession. We make this point because this taxpayer seems to be one of the opinion that even if the Bank were not concerned with the transaction here, the physical possession of the wine by the warehouse company might prevent the imposition of the tax. It is clear that such a construction of the statute is not tenable.

Nor does the dictionary definition suggest that the holding of property depends on the technicalities of title. Moreover, the Supreme Court has said that under common understanding, to hold property means to own it (*McFeely v. Commissioner*, 296 U.S. 102; *Helvering v. Gambrill*, 313 U.S. 11), but it has also said that the taxing statutes are less concerned with refinements of title than they are with the actual command or control

of property. *Corliss v. Bowers*, 281 U.S. 376, 378; *Griffiths v. Commissioner*, 308 U.S. 355, 357.

Taxation is eminently a practical matter and courts look through form to substance in tax cases whether the problem is that of determining property rights or the construction of contracts or other matters. *Tyler v. United States*, 281 U.S. 497; *Commissioner v. Moore*, 48 F. 2d 526, 528 (C.C.A. 10th). That taxation should not be made to depend on the technicalities of conveying (*Helvering v. Hallock*, 309 U.S. 106) seems obvious. Moreover, the rule is not novel. It is in line with the policy which courts have long followed in protecting the mortgagor or pledgor and in dealing with them as the true owners, regardless of liens or technicalities of title. Cf. *Helvering v. Hutchings*, 312 U.S. 393, in which it was recognized that where a donor conveys property in trust for the benefit of certain persons, the latter, who have only an equitable interest, and not the trustees, are the donees for tax purposes. Also see *Commissioner v. Nevius*, 76 F. 2d 109 (C.C.A. 2d), certiorari denied, 296 U.S. 591, in which the court, in replying to a question involving equitable interests, said (p. 110):

Historically it may be accurate to think of equitable interests in property as merely rights in personam against the holder of the legal title. * * * But it is most unlikely that the framers of a tax statute intended to carry any such nice distinctions into their legislation. Equitable interests are so common and so valuable that it is incredible that they should be excluded from taxation. The naked legal title of a trustee during the continuance of the trust has no pecuniary value.

The application of these principles to the facts here involved compels the conclusion that the taxpayer had the substantial rights of ownership of the wine.

The taxpayer here apparently agrees that the word "held" may be used in the sense of ownership in Section 10(c) but asserts that it was not the owner of the wine because negotiable warehouse receipts covering the wine had been issued to a bank from which it had borrowed money. The argument is not entirely clear since the taxpayer seems to assume that the wine was sold to the Bank, but to concede that it nevertheless retained an equitable interest in the wine. But there can be no doubt that the taxpayer's whole argument is based on technicalities of title.

It is obvious, however, that the taxpayer's agreement with the Bank was merely a plan adopted to give credit to the taxpayer. As a producer of wine, the taxpayer wished to offer such wine as security for the money he needed and was able to borrow from the Bank. Since the Government required the taxpayer to store its wine in a bonded warehouse and the Bank would not have been in a position to take the wine anyway, the parties did the only thing which could have been done under the circumstances, and that was to deliver to the Bank the warehouse receipts covering the wine. This was a symbolic delivery of the wine but it was in no sense a sale, as the taxpayer infers. The parties neither treated it as a sale nor intended it to be one. Consequently, although what the parties did in order to afford the taxpayer the desired credit might be construed as affecting a transfer of a qualified legal

title to the bank, nothing was done which requires this Court to hold that the taxpayer was deprived of its ownership of the wine, as that term must be defined here.

The evidence shows that the warehouse which stored the wine here was established by a corporation under special permission granted by the Treasury Department and for the sole purpose of storing the wine which was to be used as the basis for securing credit. (R. 51-53.) When the warehouse receipts were issued, they all called attention to this fact and thus indicated that the delivery to the Bank was for credit purposes. (R. 61.) Moreover, the Bank and the taxpayer executed a collateral agreement in which it was provided that in consideration of advances made or to be made by the Bank, the taxpayer described therein as "the owner", was assigning, transferring and depositing certain property with the Bank *as security for its debts*. (R. 64-65.) This agreement authorized the Bank to sell such property in case of the taxpayer's default or insolvency, or the wine's deterioration in value, but required the Bank to pay any surplus from a sale to the taxpayer. (R. 67-68.) From this it is clear that the warehouse receipts were delivered to the Bank pursuant to such agreement and merely as security. Thus, regardless of what might have happened if the warehouse receipts had been legally transferred to another party by the Bank, it must be admitted that we do not have such a situation here. The Bank never transferred the receipts and since none of the conditions happened which would have permitted the Bank to sell the wine, it was never in a position to demand the wine

or to act on its warehouse receipts. Consequently, the taxpayer remained for all practical purposes as much the owner of the wine as if the warehouse receipts had never been delivered to the Bank. And that was in fact the way the parties treated the taxpayer. The stipulation of facts indicates that after the loans were made and the receipts delivered to the Bank, the taxpayer was permitted by the Warehouse Company to have access to the bonded storeroom "for the purpose of servicing and caring for said wine". (R. 29, 64.) If the taxpayer had sold the wine to the Bank, or no longer had an interest in it, it would not have had, of course, any reason to look after the wine.

The stipulation shows further that it was the taxpayer who secured the purchasers of the wine and actually prepared the wine for shipment after approval of the proposed purchaser had been given by the Bank. (R. 25-26, 71-72.) And it was the taxpayer who made the reports to the Government as to the wine. (R. 26, 72.) Furthermore, while the taxpayer asserts that the Bank owned the wine, it stipulated that the Bank did not pay any personal property taxes thereon. (R. 29, 73.)

We submit that these facts clearly show that as between the taxpayer and the Bank, the former was the owner of the wine, and there are no other parties concerned with it (except the warehouse company which could not possibly qualify as owner under the facts here). Thus, we must conclude that the taxpayer held the wine as required by the statute. As we have indicated, it is not necessary to speculate what the situa-

tion might have been with different facts. We are required to consider only the facts which are before us. Moreover, it may not be necessary to determine what the transaction between the Bank and the taxpayer should be called inasmuch as the collateral agreement did not intend the transfer of the receipts to constitute a sale, and for tax purposes the taxpayer was the owner. However, as the taxpayer's brief considers the legal implications of the transaction at length, we will also discuss the point.

It is our position that the taxpayer pledged the warehouse receipts to the Bank because in California (1) a pledge is a deposit of personal property *by way of security* for the performance of another act, and (2) every contract made in California by which possession of personal property is transferred *as security only* is deemed to be a pledge. Sections 2986 and 2987, Deering's Civil Code of California (1931), Appendix, *infra*. It is, of course, true in California, as well as generally, that while a pledger surrenders possession of the pledged property to the pledgee or a pledge holder, such as the warehouse company, he does not usually give up his legal title. Obviously when something negotiable is pledged, such as the warehouse receipts here, and title goes with the physical delivery of such receipts, the owner parts with his legal title until his debt is paid, but so far as the pledgee-creditor is concerned, such transfer is subject to the terms of their agreement.⁵ And the possession of a warehouse

⁵The correctness of our contention is shown by the California statute covering warehouse receipts, particularly Section 42, Title

receipt is not conclusive proof as it is only *prima facie* evidence of ownership. *Akron Cereal Co. v. First Nat. Bank*, 3 Cal. App. 198, 201.

Moreover, while legal title apparently passed to the Bank for the limited purpose indicated, there is nothing in the Warehouse Receipts Act of California discussed in the taxpayer's brief (pp. 40-41), which is in conflict with the view that the receipts here were merely pledged and that the taxpayer remained the owner of the wine for all practical purposes. This being so, there is nothing in the California law which would prevent due effect being given to the agreement as executed by the Bank and the taxpayer. The plan followed by the parties is one which has long been known and approved in business circles, and there is no doubt that transactions like the one here are treated as pledges. To this effect, see *Dale v. Patison*, 234 U.S. 399; *Union Trust Co. v. Wilson*, 198 U.S. 530; *Taney v. Penn Bank*, 232 U.S. 174, 184; *McCaffey C. Co. v. Bank of America*, 109 Cal. App. 415, 428.

Even the case of *Heffron v. Bank of America Nat. Trust & Savings Ass'n*, 113 F. 2d 239 (C.C.A. 9th), cited by the taxpayer (Br. 50-52), is in accord with this view. There the question was whether upon the bankruptcy of the debtor-pledgor, the Bank which held

633, Deering's General Laws of California (1931), which provides in part as follows (p. 4984):

§ 42. What is acquired by transfer of receipt. A person to whom a receipt has been transferred but not negotiated acquires thereby as against the transferor, the title to the goods, *subject to the terms of any agreement with the transferor.* [Italics supplied.]

* * *

the warehouse receipts as pledgee had a valid lien in view of the fact that there was failure to meet certain requirements of the California Bulk Sales Act. This Court held that the Bank had a valid lien and that a portion of the latter act had been repealed. However, in reaching its decision, this Court recognized the right of a person in the position of the taxpayer here to pledge warehouse receipts, for it stated (p. 242):

The right is unconditionally bestowed on the owner of warehoused goods to convey *or pledge his title* by a transfer of the warehouse receipt.
* * * [Italics supplied.]

Obviously, when an owner pledges, rather than conveys, his property, he is not required by the well established principles governing pledges to part completely with his interest in the property but is merely required to give the creditor-pledgee certain rights pending the time the debt is unpaid, and when the debt is paid they are restored to the pledgor.

Thus, we submit that the Bank here was merely a pledgee and not the owner, and we find support for such view, not only in cases already referred to, but also in the California Warehouse Receipts Act on which the taxpayer places so much reliance. That act, in Section 58, Title 633, Deering's General Laws of California (1931), in defining various terms states that an " 'Owner' does not include mortgagee or pledgee". Thus, under that act the Bank here, being a pledgee, would not be treated as the owner. In this connection it should be noted that in the collateral agreement with the Bank, the taxpayer waived the provision of Sec-

tion 3006 of the Civil Code of California. (R. 68.) Section 3006 (Appendix, *infra*) refers only to pledgees and prohibits sales of pledged property by a pledgee except as to certain named obligations. We think the taxpayer's waiver of this provision is significant since it indicates that the parties themselves considered the Bank to be merely a pledgee, but by the waiver the Bank was given the right to sell. However, such right was permitted only to the extent indicated in the agreement. Consequently, in legal effect the Bank got a qualified, not an absolute title to the wine. To this effect, see *Douglass v. Wolcott Storage & Ice Co.*, 251 App. Div. 79; *Driggs v. Dean*, 167 N.Y. 121; *Millichamp v. First Nat. Bank of Toppenish*, 130 Wash. 175. These cases involve warehouse statutes similar to the one in California and are in accord with our view here.

The taxpayer's argument that it could not set up its own title "to defeat the pledge of the property by the warehouse company to the Bank" (Br. 42) is untenable, because if either the Bank or the warehouseman should refuse to deliver the liquor to the taxpayer after it had carried out its contractual obligations, it could have filed suit to assert its title and recover its pledged property. Section 3008, Civil Code of California, Appendix, *infra*; *Bell v. Bank of California*, 153 Cal. 234.

In its effort to show that it does not come within the terms of the revenue statute here, the taxpayer has cited many cases and authorities (Br. 27-54), but we have found none of them which support its contention

that it did not hold the wine on January 12, 1934, because it was not then the owner within the meaning of the statute. Of the numerous cases cited, the one which appears to present a situation most nearly like the one here is *Earle C. Anthony (Inc.) v. United States*, 57 C. Cls. 259. That case arose under a revenue statute imposing a tax on various articles, including automobiles, "held and intended for sale", but the question there was whether an automobile which had been sold by the taxpayer, a dealer, under a conditional sale contract was still "held and intended for sale" because the taxpayer could recover it from the purchaser in case the latter defaulted on his payments. The court correctly decided that the automobile was no longer held by the taxpayer because the latter intended to make a sale when the contract was executed and the car was delivered to the purchaser. Under such circumstances, the court held that the reservation of title did not prevent its holding that a sale had been made before the critical date of the statute. We submit that this case actually supports our contention in that it shows that the person having legal title may not actually be the "holder" or actual owner of the property. Instead, the real owner there, as well as here, was the one who had an equitable interest and was in a position to acquire legal title under the conditions of the agreement.

II.

THE TAX IMPOSED HERE DOES NOT VIOLATE ANY PROVISION OF THE CONSTITUTION AND IS A VALID EXCISE TAX.

The taxpayer also contends that even if it does come within the provisions of Section 10(c) of the Liquor Taxing Act, such tax is invalid for the reasons that (1) it is a direct tax upon property and is in violation of Section 9, Clause 4 of Article I of the Constitution (Appendix, *infra*) in that it is not in proportion to the census; (2) it is not apportioned among the several states and so violates Section 2, Clause 3 of Article I of the Constitution (Appendix, *infra*); and (3) it imposes a tax upon one class of persons only and constitutes a violation of the Fifth Amendment (Appendix, *infra*).

The District Court overruled these objections and in doing so pointed out that the presumption in favor of the constitutionality of a statute is strong, and that the taxpayer had failed to sustain its burden of showing that the statute is invalid. We submit that the District Court's decision is in accord with many decisions.

Article I, Section 8, Clause 1 of the Constitution gives Congress the power "To lay and collect Taxes, Duties, Imposts and Excises" (Appendix, *infra*). All such taxes, etc., must be uniform throughout the United States, but such uniformity is geographic, not intrinsic. *Bromley v. McCaughn*, 280 U.S. 124; *Knowlton v. Moore*, 178 U.S. 41. The tax here applied to all wine producers in the United States on January 12, 1934, holding wine intended for sale or use in the

manufacture of articles intended for sale. Thus, there is no real foundation for the taxpayer's contention here that this tax lacks the uniformity required by Article I, Section 2, Clause 3 of the Constitution.

We also submit that this tax is not a direct tax. It is, of course, now settled that taxes levied upon, or collected from, persons because of their general ownership of property are direct and so must be in proportion to the census, as the Constitution requires. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 158 U.S. 601. But the Supreme Court has consistently held almost from the foundation of the Government, that a tax imposed upon a particular use of property or exercise of a single power over property incidental to ownership is an excise, or indirect, tax which need not be apportioned. *Bromley v. McCaughn*, *supra*, p. 136. The following have been sustained as indirect taxes: Taxes on particular types of sales (*Nicol v. Ames*, 173 U.S. 509; *Thomas v. United States*, 192 U.S. 363); upon the use of carriages for the conveyance of persons (*Hylton v. United States*, 3 Dall. 171); upon the amount of notes paid out by any state bank (*Veazie Bank v. Fenno*, 8 Wall. 533); upon manufactured tobacco, having reference to its origin and intended use (*Patton v. Brady, Executrix*, 184 U.S. 608); upon the manufacture and sale of colored oleomargarine (*McCray v. United States*, 195 U.S. 27); a succession tax upon the devolution of title to real estate (*Scholey v. Rew*, 23 Wall. 331); a tax on legacies (*Knowlton v. Moore*, *supra*); and taxes on doing business by particular methods (*Flint v. Stone Tracy Co.*, 220 U.S. 107;

Spreckels Sugar Refining Co. v. McClain, 192 U.S. 397).

The tax here is laid upon the exercise of a single power incident to ownership, namely, the power of an owner, who is a wine producer, to hold such wine for sale or for use in the manufacture of articles intended for sale. Consequently, this tax is an excise tax⁶ and falls in the same class as the cases just cited. And this was the holding in *Commonwealth of Pennsylvania v. Fix*, 9 F. Supp. 272 (M.D. Pa.), affirmed *sub nom. Commonwealth of Pennsylvania ex rel Margiotti v. Kyle*, 79 F. 2d 520 (C.C.A. 3d), certiorari denied, 297 U.S. 704. The taxpayer seeks to discount the decision in that case by stating that the District Court's decision is "at best poor dictum" (Br. 66), but it will be seen from the District Court's opinion that (1) the same statutory provision involved here was construed in that case; (2) the State of Pennsylvania, in seeking to avoid paying tax on liquor held by it, raised the same constitutional questions; and (3) the District Court held that the tax imposed in this statute is an excise tax, not a direct tax, and need not be apportioned. We submit that this is a direct ruling in favor of the Government on our questions here, and this case was affirmed on appeal.

Furthermore, as was pointed out in the *Fix* case, the statutory provision imposing the tax here is very similar to that involved in *Patton v. Brady*, *supra*. That case arose under Section 3 of the Act of June 13, 1898, to provide ways and means to meet the expenditures

⁶See definition in *Knowlton v. Moore*, *supra* (p. 88).

of the Spanish-American War. Section 3 first provides, in lieu of the tax then imposed, another tax upon all tobacco and snuff however prepared, manufactured and sold for consumption or sale. It provides further for an additional tax, as in the statute here, on such articles then "held and intended for sale".⁷ It will be seen that there is in fact no material difference in the two statutes, and the Supreme Court upheld this additional tobacco tax as a valid excise tax.

We submit that the same conclusion should be reached here. The taxpayer also refers to the Fifth Amendment (Br. 56), but merely states, without discussion, that this tax violates the due process clause. It is, of course, well established that the Fifth Amendment is not a general limitation on the taxing power of the Federal Government (*Brushaber v. Union Pac. R. R.*, 240 U.S. 1), and since there is nothing arbitrary or capricious about the imposition of this tax, the objection is without substance.

⁷The provision imposing such additional tax reads as follows (c. 448, 30 Stat. 448, 450):

And there shall also be assessed and collected with the exceptions hereinafter in this section provided for, upon all the articles enumerated in this section which were manufactured, imported, and removed from factory or custom-house before the passage of this Act bearing tax stamps affixed to such articles for the payment of the taxes thereon, and canceled subsequent to April fourteenth, eighteen hundred and ninety-eight, and *which articles were at the time of the passage of this Act held and intended for sale by any person*, a tax equal to one-half the difference between the tax already paid on such articles at the time of removal from the factory or custom-house and the tax levied in this Act upon such articles. [Italics supplied.]

* * *

As in this case, the taxpayer in *Patton v. Brady, Executrix, supra*, protested on the ground that this additional tax was not a valid excise tax, but the Court overruled its objections.

CONCLUSION.

The decision of the District Court is correct and should be affirmed.

Dated, November 18, 1942.

Respectfully submitted,

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(Appendix Follows.)

Appendix.

Appendix

Liquor Taxing Act of 1934, c. 1, 48 Stat. 313:

SECTION 1. This Act may be cited as the
“Liquor Taxing Act of 1934”.

* * * * *

SEC. 8. Section 612 of the Revenue Act of 1918, as amended (relating to the tax on grape brandy and wine spirits withdrawn and used in the fortification of wines) [U.S.C., Sup. VI, title 26, sec. 1301], is amended by striking out “10 cents per proof gallon” and inserting in lieu thereof “20 cents per proof gallon”.

* * * * *

SEC. 10. (a) Upon all distilled spirits produced in or imported into the United States upon which the internal-revenue tax imposed by law has been paid, and which, on the day this title takes effect, are held by any person and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor tax equal to the amount if any, by which the tax provided for under this title exceeds the tax so paid, not including in the computation of the tax so paid the 30 cent tax imposed by section 605 of the Revenue Act of 1918.

* * * * *

(c) Upon all wines held by the producer thereof upon the day this title takes effect and intended for sale or for use in the manufacture or production of any article intended for sale, there shall be levied, assessed, collected, and paid a floor tax equal to the amount, if any, by which the tax provided for under section 8 of this title exceeds

the tax paid upon the grape brandy or wine spirits used in the fortification of such wine.

* * * *

SEC. 13. This title shall take effect on the day following its enactment.

Constitution of the United States:

Article. I.

* * * *

Section. 2. * * *

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, * * *

Section. 8. The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, * * *

Section. 9. * * *

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

AMENDMENT 5.

No person shall be * * * deprived of life, liberty, or property, without due process of law: * * *

Deering's Civil Code of California (1931), c. III:

SEC. 2986. *Pledge, what.* Pledge is a deposit of personal property by way of security for the performance of another act.

SEC. 2987. *When contract is to be deemed a pledge.* Every contract by which the possession of personal property is transferred, as security only, is to be deemed a pledge.

SEC. 2988. *Delivery essential to validity of pledge.* The lien of a pledge is dependent on possession, and no pledge is valid until the property pledged is delivered to the pledgee, or to a pledgeholder, as hereafter prescribed.

* * * * *

SEC. 2991. *Real owner cannot defeat pledge of property transferred to apparent owner for the purpose of pledge.* One who has allowed another to assume the apparent ownership of property for the purpose of making any transfer of it, cannot set up his own title, to defeat a pledge of the property, made by the other, to a pledgee who received the property in good faith, in the ordinary course of business, and for value.

* * * * *

SEC. 2993. *Pledge-holder, what.* A pledgor and pledgee may agree upon a third person with whom to deposit the property pledged, who, if he accepts the deposit, is called a pledgeholder.

* * * * *

SEC. 3000. *When pledgee may sell.* When performance of the act for which a pledge is given is due, in whole or in part, the pledgee may collect what is due to him by a sale of property pledged, subject to the rules and exceptions hereinafter prescribed.

* * * * *

SEC. 3001. *Sale of pledged property.* Before property pledged can be sold, and after performance of the act for which it is security is due, the pledge, must demand performance thereof from the debtor, if the debtor can be found.

* * * * *

SEC. 3006. *Pledgee's sale of securities.* A pledgee cannot sell any evidence of debt pledged to him, except the obligations of governments, states, or corporations; but he may collect the same when due.

* * * * *

SEC. 3008. *Surplus to be paid to pledgor.* After a pledgee has lawfully sold property pledged, or otherwise collected its proceeds, he may deduct therefrom the amount due under the principal obligation, and the necessary expenses of sale and collection, and must pay the surplus to the pledgor, on demand.

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

District Court No. 20,473-S

MOUNT TIVY WINERY, INC. (a corporation), *Appellant*,
 vs.

JOHN V. LEWIS, Collector of Internal Revenue, First California
 District, and UNITED STATES OF AMERICA, *Appellees*.

District Court No. 20,464-R

CALIFORNIA WINERIES AND DISTILLERIES, INC. (a corporation),
 vs. *Appellant*,

JOHN V. LEWIS, Collector of Internal Revenue, First California
 District, and UNITED STATES OF AMERICA, *Appellees*.

District Court No. 20,465-L

FRESNO WINERY, INC. (a corporation), etc., *Appellant*,
 vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al.,
Appellees.

District Court No. 20,466-R

SANTA LUCIA WINERIES, INC. (a corporation), *Appellant*,
 vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al.,
Appellees.

District Court No. 20,467-S

CHARLES DUBBS and SAMUEL CAPLAN, Co-partners doing business
 as ALTA WINERY AND DISTILLERY, *Appellants*,
 vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al.,
Appellees.

District Court No. 20,474-W

CALIFORNIA GROWERS WINERIES, INC. (a corporation),
 vs. *Appellant*,

JOHN V. LEWIS, Collector of Internal Revenue, et al.,
Appellees.

District Court No. 21,113-L

ST. GEORGE WINERY (a corporation), *Appellant*,
 vs.

JOHN V. LEWIS, Collector of Internal Revenue, et al.,
Appellees.

APPELLANTS' REPLY BRIEF.

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ISSUES CLARIFIED.

Since filing the opening brief several matters have been clarified by admissions in the government's reply brief.

As pointed out in *Deputy v. Du Pont*, 308 U. S. 488, 499, the facts and the law involved in these cases is open for determination here, unfettered by findings and rulings below.

FACTS AGREED UPON.

Inasmuch as the facts were agreed upon in written stipulations (R. 14-36), there should be no question as to these facts. However, appellants disagree with certain inferences and conclusions drawn therefrom by appellees in their Brief filed herein, which will be discussed later.

LEGAL ISSUES DISPUTED.

The major controversy arises in the application of the law to the agreed statement of facts. In this regard the legal issues involved are disputed, as are certain inferences and conclusions drawn by appellees from the facts agreed upon.

ISSUES.

Appellants contend (See Appellants' Opening Brief, pages 27-54, hereinafter referred to as AOB), that the wine, upon which the tax was assessed and col-

lected, was not "held" by them on January 12, 1934, within the meaning of Section 10(c) of the Liquor Taxing Act of 1934, c. 1, 48 Stat. 313, 26 U.S.C.A. §451(b), 1934 Cumulative Annual Pocket Part, which contention is denied by Appellees (Brief for Appellees, pages 15-26, hereinafter referred to as BA).

Further, Appellants contend that even if it be found that such wine was so "held" by them on the taxable date, that nonetheless they were not liable for the tax assessed and collected because the tax imposed, under Section 10(c) of the Liquor Taxing Act of 1934, was a direct, rather than an excise, tax and was in violation of the provisions of the United States Constitution set forth in AOB, pages 55-56. Again, Appellees oppose this contention and conclude (BA 27-31) that the tax imposed was and is a valid excise tax and hence does not violate any provision of the Constitution.

With the major legal issues joined, a re-examination of the facts (R. 14-36) is necessary. (See AOB 7-18 and BA 3-14).

DISAGREEMENT AS TO INFERENCES AND CONCLUSIONS.

Appellants and Appellees are in disagreement as to the correct inferences and conclusions to be drawn from the statement of facts agreed upon.

On pages 5-6 BA, Appellees infer that the only way that the wine, covered by the warehouse receipts, could be disposed of is *upon foreclosure*, whereas the

fact is (R. 34, Exhibit "A") that the wine could be disposed of "*upon foreclosure or otherwise*".

Likewise, Appellees infer (BA 6) that the wine, covered by the warehouse receipts, could only be transferred to a permit holder because (R. 34, Exhibit "A" 1(1)) the power or authority to possess or use the wine could only be disposed of to a bona fide holder of a permit entitling the permittee to acquire or otherwise deal with the said wine. While the warehouse receipts themselves could only be transferred to a permit holder, so far as the power or authority to possess or use the wine covered thereby, nowhere is the attention of this Court directed to any prohibition against the transfer of the warehouse receipts and the title to the wine to one other than a permit holder. Of course, if such a transfer of title occurred the new owner merely could not possess or use the wine, unless a permit holder.

TRANSFER OF WAREHOUSE RECEIPTS NOT INVOLVED.

Appellees overlook, apparently, that the issue as to the transferability of the warehouse receipts to the Bank is not involved here because the Warehouse Receipts, negotiable in form, were not transferred to the Bank, rather they were issued by the warehouse in the name of and delivered to the Bank by the warehouse as the owner of the wine described therein. Even the fact that these Receipts were issued in the name of the Bank is omitted in Appellees' Statement of Facts (BA 9). It is important to remember that

these Warehouse Receipts were never issued in the name of or to the order of Appellants, nor were they delivered to Appellants by the Warehouse or the Bank. Consequently, these Warehouse Receipts could not have been delivered by Appellants to the Bank as *security* or as a "*pledge*" under the Collateral Agreement executed between Appellants and the Bank (R. 34, Exhibit "M-1"). Therefore, the statement by Appellees (BA 14-15), "The evidence shows that the receipts were delivered to the Bank *pursuant* to an agreement which gave the terms of loans made by the Bank to the taxpayer and *indicated* that such receipts were being transferred as a *pledge*, not as a result of a sale to the Bank. Thus, the Bank held the receipts merely as *security* for these loans and could claim the wine *only in case of default*, but as there was no default, it never had a right to take the wine from the warehouse." is an unwarranted conclusion from the agreed and actual facts. As pointed out later, the Stipulation of Facts, except as to the assessment and collection of taxes imposed, related solely to the period up to and including *January 12, 1934*. In fact defaults did occur thereafter, contrary to the statement of Appellees.

ACTS, RATHER THAN INTENT, CONTROL.

In other words, it is necessary for this Court to ascertain what was done by Appellants, the Warehouse and the Bank, rather than what these parties might have intended to do. Actions, rather than words, should be determinative of the legal issues presented.

It is admitted that Appellants and the Bank executed the Collateral Agreement which probably contemplated that collateral security of some kind would be forthcoming, in which case any property so received as collateral security would be subject to the terms and conditions of the agreement.

**RECEIPTS ISSUED PRIOR TO EXECUTION OF
COLLATERAL AGREEMENT.**

However, it should not be forgotten that most of the Warehouse Receipts involved were issued to the order of and were delivered by the Warehouse to the Bank prior to the execution of the Collateral Agreement, as were promissory notes evidencing advances of money to Appellants by the Bank for credit purposes to enable Appellants to produce, process and manufacture the wine (R. 20-21).

ONLY PROPERTY OWNED ASSIGNED.

Further, as pointed out in paragraph two of the Collateral Agreement, contrary to the inference of Appellees (BA 10), not *all* property delivered to the Bank "then or later" would be assigned to, or deposited with the Bank. Rather, the agreement states that only that property of which the Appellants are the owners would be so assigned or deposited.

Under paragraph four of this agreement (R. 34, Exhibit "M-1") the Bank was authorized to transfer

any warehouse receipts or other collateral security to its own or to the name of any other person, as pledgee, trustee, or otherwise. Therefore, had the Bank received the Warehouse Receipts in question as collateral security under the collateral agreement, and had thereafter caused the same to be transferred to its own name, it would have become the owner thereof by such action, unless it had designated that it held the security in its name as pledgee or trustee, and not *otherwise*, in view of the provisions of the California Uniform Warehouse Receipts Act. (AOB 41-42).

RECEIPTS ENDORSED AND NEGOTIATED.

The statement by Appellees (BA 11), "None of the receipts were ever endorsed or negotiated by it" is untrue as shown in the Stipulation of Facts (R. 26-27). Further, with the exceptions therein noted, the Stipulation of Facts concerning endorsement and negotiation of the receipts covers the period up to and including January 12, 1934 only, because, although not covered by the Stipulation because believed not necessary to the determination of the case, certain of the warehouse receipts were negotiated and endorsed by the Bank to another bank sometime after January 12, 1934.

RECEIPT AUTHORIZED FOR CREDIT PURPOSES.

Appellees seek to establish that regardless of the fact that the warehouse receipts were originally issued

in the name of and delivered to the Bank by the warehouse, that when the Bank received these warehouse receipts it did so, not as the “owner” and entitled to the possession of the wine represented thereby, but rather as a “pledgee” under the Collateral Agreement, even though the warehouse receipts were issued before the Collateral Agreement was executed. Obviously, Appellees overlook the express provisions of Exhibit “A” (R. 34) which expressly authorized the storage of wine for “credit purposes”; also, that said regulation, known as Treasury Decision 19, merely prohibited any person, firm or corporation advancing credit upon the security of such wine or upon the security of warehouse receipts or other instruments issued on account thereof from having the power or authority to possess or use the wine in any manner or to dispose of it upon foreclosure or otherwise. This regulation did not prohibit the transfer of title to the wine represented by the warehouse receipts to one other than a bona fide holder of a permit entitling the permittee to buy or otherwise deal with the wine; also, it did not prevent such other person from claiming the wine. As the warehouse receipts were issued in the name and delivered to the Bank, Appellees’ argument (BA 15) that the Bank could claim the wine only in case of default, is contrary to the facts and the California Uniform Warehouse Receipts Act, Ante, Section 8 (See also AOB 41-46 for other authorities).

CREDIT DEFINED.

“*Credit*” is defined by Webster’s New International Dictionary, 1930 edition, as “to trust, loan, believe”. For commercial purposes, that authority defines credit as “trust given or received; expectation of future payment for property transferred or of fulfillment of promises given; the relative circumstances between one person and another who trusts in him to pay or render a sum in the future; mercantile reputation entitling one to be trusted as, to buy goods on credit. Credit is nothing but an expectation of money, within some limited length of time. Locke. The time given for payment for lands or goods sold on trust; as, as long credit or short credit.”

Further, this same authority defines *credit* for bookkeeping purposes as, “a. Acknowledgment of payment by entering in an account; b. The side of an account on which are entered all items reckoned as values received from the party or the category named in the head of the account; also, any one, or the sum of these items; the opposite of debits as, this sum is carried to one’s credit, and that to his debit”; also, as “the balance in a person’s favor in an account; also, an amount or limit to the extent of which a person may receive goods or money on trust; specifically an amount or sum placed at a person’s disposal by a bank.”

This same authority also defines *credit* as “to sell goods to on credit”, and “to enter upon the credit side of an account; to give credit for; as, to credit to a man the amount paid; to place to the credit of; as, to credit a debtor with an amount paid.”

From these definitions of credit it is obvious that the warehouse receipts were issued in the name of and delivered to the Bank in consideration of credit extended, for credit purposes, by the Bank prior to the execution of the Collateral Agreement. There was no prohibition in the regulations against the issuance of the warehouse receipts in the name and to the order of the Bank. It was not necessary that the warehouse receipts be issued and delivered to the Appellants or thereafter delivered by Appellants to the Bank as collateral security. Consequently, it is significant that these latter steps did not occur, as is inferred and urged by Appellees.

SALE OF WINE OCCURRED.

Therefore, as is pointed out in *Earle C. Anthony, Inc. v. United States*, 57 C. Cls. 259, the mere fact that Appellants might have been entitled, pursuant to agreement or understanding with the Bank, to have the wine returned to them upon payment of any sums due from Appellants to the Bank, such circumstances would not prevent the transfer being a sale. In other words, a mere right retained or a reservation of title does not prevent a transaction from becoming complete and, subject to the provisions, in the instant cases, of the Uniform Warehouse Receipts Act under which the Bank became the owner and entitled to the possession of the wine, subject, of course, to T. D. 19.

**“TO HOLD” HAS A DIFFERENT MEANING
THAN “HELD”.**

Obviously, Appellees fail to realize that the words “to hold” have an entirely different meaning than the word “held” used in the instant tax statute. For example, one can ask another “to hold” something for him, regardless of whether such person owned or had the title to the article in question. Also, “to hold” can refer to a condition in which there is no ownership or title, as in the case of the adverse possession of real property or the hypothecation of personal property. As set forth in AOB 29-30, the word “held” implies ownership and refers to one who has the legal right or title to a thing, whether the possessor or not.

Therefore, Appellees are not entitled to the construction of the tax statute urged (BA 16-19), that will extend, by implication or otherwise, the natural, ordinary and generally understood meaning of the term “held” used (AOB 22-27). Nor are Appellees entitled to a construction of the tax statute which will create an ambiguity or otherwise resolve a doubt in their favor rather than in favor of Appellants (AOB 33-35).

**APPELLANTS PERFORMED CONTRACTUAL
OBLIGATIONS.**

Appellees argue at length (BA 19-22), in substance, that the actions of the Appellants in caring for the wine, payment of the personal property taxes thereon, etcetera, establishes that appellants had an interest

in the wine. They do not point out clearly that all of Appellants' actions were pursuant to and in performance of contractual obligations and supported by good consideration, which fact justifies a different inference being drawn from the statement of facts than that advanced by Appellees.

BANK IS "OWNER" RATHER THAN "PLEDGE".

Appellees make much of the provision in the Collateral Agreement (AB 24-25) wherein the provisions of Section 3006 of the Civil Code of California are waived. Appellants contend that the provisions of the Civil Code, relating to pledges, are inapplicable to the instant cases, for reasons previously discussed; also that it is immaterial if they are applicable. Moreover, a reading of Sections 2986-3011, inclusive, of the Civil Code of California, relating to Pledges, defines the nature and character thereof and outlines the duties and obligations of a pledgee. These provisions, among other things, prohibit a sale of the property pledged until performance has been demanded and notice of sale has been personally given to the pledgor, also, specifies that the sale must be by public auction and the proceeds disposed of as therein set forth. In the instant cases, the Bank sold substantial quantities of the wine covered by the warehouse receipts from time to time, and even had new receipts, negotiable in form, issued to it, without any compliance with these provisions of the Civil Code. Certainly, this should indicate that in so far as the

warehouse receipts here are concerned, that they were taken and held by the Bank as owner, rather than under the provisions of the Collateral Agreement, because under the Collateral Agreement a full compliance with the law of pledges would have been necessary in the event the Bank was a pledgee, as contended by Appellees, of the warehouse receipts.

WAREHOUSE RECEIPTS TRANSFERRED.

In the four cases cited by Appellees (BA 23-25) to support the statement that the Bank got a qualified, not an absolute, title to the wine, it is significant that therein warehouse receipts were originally issued in the name of the transferor and were thereafter endorsed, transferred, and delivered by the transferor to the pledgee as collateral security under a pledge agreement. This situation is not present here. Moreover, in those cases, while the courts therein state that the Bank on a pledge did get a qualified title, apparently they find no qualifications on the title, other than the pledgor's right to redeem and the liability for storage charges. As is pointed out in the case of *Heffron v. Bank of America N. T. & Savings Ass'n*, 11 F. (2d) 239 (C. C. A. 9th), and in other cases cited in Appellants' Opening Brief, one to whom the title to property has been transferred is entitled to retain the wine even against the trustees of the transferor, pledgor or mortgagor or his creditors. Certainly, Appellees do not possess the same equitable rights as these parties. Therefore, it is illogical to

contend that for tax purposes a debtor owns or is entitled to the possession of property whereas such is not true in other cases even where the equities are involved.

PLUGGING THE GAP.

Appellees seek to have this Court "plug a gap" which exists in the Liquor Taxing Act of 1934, which gap is occasioned by the failure to include within the tax law express language to include the provision which Appellees now desire to have inserted therein by this Court. They are trying to correct this admitted oversight by judicial decision incorporating therein additional language and a new construction. That this cannot be done at this time is clearly indicated in the decisions set forth in the Appellants' Opening Brief (Pages 22-37, 33-35).

In *Douglass v. Wolcott Storage & Ice Co.*, 295 N. Y. S. 675, 251 App. Div. 79, plaintiff, who had endorsed and delivered negotiable warehouse receipts as collateral security for a debt, was denied the right of recovery against the warehouse for damages to the property covered by the warehouse receipts because, as the Court says (Page 678):

"Plaintiff did not then own or have a right to dispose of a part of this fruit";

also,

"* * * plaintiffs can hardly be heard to say that they sold or attempted to sell merchandise that they did not own or to which they could not convey a good title."

Even a guarantor of a note, to whom a warehouse receipt deposited as collateral security, had been transferred, is entitled to the property. *Driggs v. Dean*, 167 N. Y. 121, 60 N. E. 336.

Further, in *Millichamp v. First National Bank of Toppenish*, 130 Washington 175, 226 Pacific 490, the Court emphasized the fact that a pledgee, to whom a warehouse receipt issued in the name of the pledgor has been deposited with the pledgor as collateral security, did not do anything which shows that the pledgee took or assumed possession, or control over the stored property, that such pledgee, holding such warehouse receipts as collateral security, could not be held liable for storage charges. As pointed out previously, the Bank in the instant cases exercised and took control over the stored property (R. 25-26), hence, except for the contractual agreement to the contrary, would have been liable for the storage charges.

GOVERNMENT ADMITS BANK HAD TITLE TO WINE.

So far as the title is concerned, Appellees admit that the title was in the Bank by virtue of the warehouse receipts (BA 23) but now contends (for previous position see AOB 48) that this was a limited title. Exactly what is meant by a limited title is a question, but apparently the Appellees' position is, that while title passed to the Bank completely, the Appellants had the right, by paying the obligation, to demand that the title to the property be returned to them. At the date of the enactment of the taxing

statute the obligation was unpaid; therefore, at that date the title was in the **Bank**.

BANK HAD POSSESSION AND CONTROL OF WINE.

On the matter of possession it is clear that the Bank was in possession by virtue of the warehouse receipts. Whether the matter be classed as a pledge according to the government's contention or whether it is an outright conveyance subject to a right to demand the return of the property upon the happening of a condition subsequent, in either event the transaction requires a change of possession. By virtue of the Warehouse Receipts Act the warehouse holds possession as an agent or bailee of the person to whom the warehouse receipts were issued.

Having both title and possession, it follows that the Bank had control and authority over the wine. The Bank could do anything it wished to with the wine, except as restricted by T. D. 19, at the date of the enactment of the statute, and the obligation not at that time having been paid, Appellants could not have maintained an action for conversion but simply an action on contract.

IMMATERIAL WHETHER INTEREST OF BANK IS AS OWNER OR PLEDGEE.

The question then arises as to the interest, if any, held by Appellants. Our position is that at that time, the date upon which the tax was fixed, Appellant had no more right in and to the wine in question than a

pledgor, if as much. In the case of *Cushing v. Building Assn.*, 165 Cal. 731, 134 Pac. 324, the California Supreme Court held that the pledgor retains no right in regard to the property other than the right to receive it from the pledgee upon paying the debt for which it was held or in the event of a sale, to receive any surplus over and above the amount necessary to satisfy the debt. The only interest Appellant had in the wine at that time was an inchoate right, to demand in the future, if the obligation was paid, that the title and possession of the wine be returned to him. If Congress had meant to tax such an interest they certainly did not state such intention in the statute.

Printing restrictions prevent a further analysis and response to the brief of Appellees at this time, relating to whether Appellants held the wine on the taxable date, other than the statement of Appellees (BA 19) that the parties did the *only* thing which could be done under the circumstances, and that was to deliver to the Bank the warehouse receipts covering the wine. In this connection, as previously indicated, Appellants could have had the warehouse receipts issued to them and thereafter hypothecate them as collateral security, and even thereafter endorse and transfer the receipts to the Bank, rather than what was done, namely, issuance in the name of the Bank and delivery of the warehouse receipts to the Bank.

CONSTITUTIONAL ISSUES INVOLVED.

Appellants deny the statement of Appellees (BA 27) that the tax was applied to all wine producers in the United States on the taxable date holding wine intended for sale or used for the manufacture of wine to be sold. Referring to Section 10(c) of the Liquor Taxing Act of 1934, it will be noted that under the express language thereof the tax is only imposed "upon all wines held by the *producers thereof*." Therefore, if a *producer* of wine held wine not *produced* by him but by another producer, no tax would be due under the express provisions of the law upon any wine so held, unless produced and held by him as a producer on the taxable date within the provisions of the tax law. Hence, the tax statute is not uniform as to all wine producers, as is required under the provisions of the Constitution of the United States cited in Appellants' Opening Brief (pages 55-56), nor does it apply to other wine otherwise held within the provisions of the tax statute by any other person than a producer thereof.

THE QUESTION OF CONSTITUTIONALITY.

We are in accordance with the statement regarding the nature of direct and indirect taxes as set forth in the Appellees' brief (page 28) observing therein the taxes held to be excise taxes in the various cases cited are upon the use or exercise of a power over property. Even in the case of *Patton v. Brady, Excutrix*, 114 U. S. 608, singled out by Appellees for

special mention, the tax was not payable until the sale of the tobacco, or in other words, until the intention to sell was actually exercised and a sale made.

If a tax such as this which taxes a mere unexpressed "intent" to do something with property rather than a use, power or privilege, in connection with the property, is upheld as an indirect or excise tax, there is no limit to the extent of the Federal Government's right to tax persons because of their general ownership of property, by merely adding the requirement of an intent to do or refrain from doing something with it.

Therefore, we respectfully submit, for these and the reasons discussed in Appellants' Opening Brief, that the judgment of the Court below should be reversed.

Dated, San Francisco,
November 27, 1942.

Respectfully submitted,
ROBERT H. FOUKE,
Attorney for Appellants.

United States
Circuit Court of Appeals
For the Ninth Circuit.

THOR W. HENRICKSEN, Acting Collector of
Internal Revenue,

Appellant,

vs.

RICHARD E. SEWARD and HELEN ROBERTS,
Liquidating Trustees of CON-ROD
EXCHANGE, INC., a Corporation,

Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Western District of Washington,
Southern Division

FILED

OCT 10 1942

PAUL P. O'BRIEN,

No. 10235

United States
Circuit Court of Appeals
For the Ninth Circuit.

THOR W. HENRICKSEN, Acting Collector of
Internal Revenue,
Appellant,
vs.

RICHARD E. SEWARD and HELEN ROBERTS,
Liquidating Trustees of CON-ROD
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Transcript of Record

Upon Appeal from the District Court of the United States
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and likewise, canceled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the District Court of the United States, for the
Western District of Washington, Southern
Division

No. 174

RICHARD S. SEWARD and HELEN ROBERTS,
liquidating trustees of CON-ROD EXCHANGE
INC., a corporation,
Plaintiff,

vs.

THOR W. HENRICKSEN, Acting Collector of In-
ternal Revenue,
Defendant.

COMPLAINT

Comes Now the plaintiff and for its first cause of
action against the defendant, alleges:

1.

That the Con-Rod Exchange, Inc., at all times
hereinafter mentioned, was a corporation, organized,
existing and doing business under and by virtue of
the laws of the state of Washington; that it was
legally dissolved under the laws of the State of
Washington on January 8, 1940; that the plaintiffs,
Richard S. Seward and Helen Roberts were the
last directors and liquidating trustees of the said
corporation, this cause of action thereby vesting in
them. That corporation's principal place of busi-
ness and plaintiffs' residence is within the judicial
district of the above entitled court. That each trus-

tee and the said corporation is and was a citizen of the United States and that each has at all times borne true allegiance to the government of the United States, and that each has not in any way voluntarily aided, abetted or given encouragement to rebellion against said United States. That plaintiffs are justly entitled to the amount herein claimed from the United States, and that no assignment or transfer of said claim or any part thereof or any interest therein has been made.

2.

That the defendant at all times hereinafter mentioned [1*] was, and still is, the acting Collector of Internal Revenue of the United States for the Collection District of Washington, having an office and residing at Tacoma, Pierce County, within the above entitled district, and that the said defendant now is a citizen of the state of Washington, Pierce County therein.

3.

That for the period from June 21, 1932, to September 30, 1935 said corporation paid to the said defendant any and all manufacturer's excise taxes due to the defendant or to the United States of America under Section 606 (c) of the 1932 Revenue Act. That on or about April 27, 1936, the defendant, acting under the instructions of the Commissioner of Internal Revenue, notified the corporation that it was liable for a further assessment under

*Page numbering appearing at foot of page of original certified Transcript of Record.

the provisions of the said Section of the said Act in the sum of \$2019.64. That thereafter, acting under the authority of the commissioner of Internal Revenue, the defendant required the corporation to and thereupon it did pay to the defendant the following amounts upon the respective dates:

Date of Payments	Amount
September 25, 1937.....	\$ 50.00
October 25, 1937.....	50.00
November 26, 1937.....	50.00
December 27, 1937.....	50.00
January 25, 1938.....	50.00
February 25, 1938.....	50.00
March 25, 1938.....	50.00
May 5, 1938.....	50.00
May 25, 1938.....	50.00
June 24, 1938.....	50.00
July 25, 1938.....	50.00
August 25, 1938.....	50.00
September 25, 1938.....	50.00
October 25, 1938.....	50.00
November 26, 1938.....	50.00
December 29, 1938.....	50.00
January 25, 1939.....	50.00
February 25, 1939.....	50.00
April 5, 1939.....	50.00
April 25, 1939.....	50.00
May 23, 1939.....	50.00
June 23, 1939.....	50.00
July 28, 1939.....	50.00
	<hr/>
	\$1,150.00

This made a total payment of \$1,150.00. That on or about the 17th day of February, 1940, plaintiffs duly filed with the defendant for transmission to the Commissioner of Internal Revenue a claim for refund and repayment of the said amount, a full,

true and correct copy of which claim is hereto attached, marked Exhibit "A", [2] and by this reference made a part hereof. That thereafter under date of April 18, 1940, the Commissioner of Internal Revenue in writing notified the plaintiffs that such claim was disallowed and rejected, a copy of which is hereto attached marked Exhibit "B" and by this reference made a part hereof.

4.

That the corporation was engaged in the business of repairing automobile parts in the city of Seattle, King County, Washington. That the transactions upon which the tax above referred to was assessed were not sales of goods manufactured or produced by the plaintiff within the intent and purpose of Section 606 of the Revenue Act of 1932, but were repairs made to automobile connecting rods, which connecting rods had at no time lost their identity as such, and were thereafter reinstalled in automobiles, and that the assessment of manufacturer's excise tax upon such connecting rods was wrongful, illegal and unwarranted, and plaintiffs are entitled to the return thereof with interest.

5.

That the charge made by the corporation for repaired automobile parts was not changed or altered in any respect because of the assessment of the tax, refund of which is now being asked, and that the corporation did not include the tax in the price or

charge of the repaired article with respect to which it was imposed by the defendant, nor was the amount of the said tax collected directly or indirectly from the customers or vendees.

6.

That on the 9th day of August, 1939, a trial was had before the above entitled court of an action by the corporation against this defendant, in which a refund of manufacturer's excise taxes was sought. That the said taxes which had been paid by the corporation were paid for the period from October 1, 1935 to August 31, 1936. That at the said trial all the allegations herein set forth in paragraphs 1 to 5, inclusive, above, excepting only the assessment of and the time of the payment of taxes, the refund of which is herein sought, the period of time for which they were [3] assessed by the defendant and the filing by the corporation of a claim for said refund in accordance with the Internal Revenue Code and the Regulations of the Commissioner of Internal Revenue were presented for determination to the said court, and were thereupon decided by the said court to be true as alleged by the corporation therein and as now set forth herein in paragraphs 1 to 5 inclusive. The said court made full and detailed findings of fact and conclusions upon the 30th day of August, 1939, which findings of fact and conclusions of law are attached hereto, marked Exhibit "C", and by this reference made a part hereof and incorporated herein as fully as though set forth herein. That upon the same date, namely, the 30th

day of August, 1939, said court ordered judgment for the corporation, a copy of which judgment is attached hereto, marked Exhibit "D" and by this reference is made a part hereof, and incorporated herein as fully as though set forth in full. The said judgment now is and stands unreversed and unmodified and in full force and effect, and the matters above set forth in paragraphs 1 to 5 inclusive, which were determined, adjudged and decreed in said decree were and are res adjudicata between the plaintiff and defendant in this cause.

As a Second Cause of Action, plaintiff further alleges:

1.

Plaintiff refers to paragraphs 1, 2, 4, 5 and 6 of its first cause of action, and by this reference incorporates the same herein as fully as though set forth in full.

2.

That for the period from June 21, 1932 to September 30, 1935, the corporation paid to the said defendant any and all manufacturer's excise taxes due to the defendant or to the United States of America under Section 606 (c) of the 1932 Revenue Act. That on or about the 27th day of April, 1936, the defendant, acting under the instructions of the Commissioner of Internal Revenue, notified the corporation that it was liable for a further assessment under the provision of the said section of said Act in the sum of \$869.64 additional tax and \$188.28 interest. That thereafter, acting under the authority

of the Commissioner of Internal Revenue, the defendant, [4] on the 23rd day of March, 1940, required the said corporation to and thereupon it did pay to the defendant the above set forth sum, a total payment of \$1,057.92; on or about the 11th day of April, 1940, plaintiffs duly filed with the defendant for transmission to the Commissioner of Internal Revenue a claim for refund and repayment of said amount, a full, true and correct copy of which claim is attached hereto, marked Exhibit "E", and is by this reference made a part hereof and incorporated herein as fully as though set forth herein. That thereafter under date of July 31, 1940, the Commissioner of Internal Revenue, in writing, notified the corporation that such claim was disallowed and rejected, a copy of which letter is attached to the original complaint herein, marked Exhibit "F", and is by this reference made a part hereof and incorporated herein as though fully set forth herein.

Plaintiff further alleges as a Third Cause of Action:

1.

By reference to paragraphs 1, 2, 4 and 5 of the first cause of action, the said paragraphs are hereby incorporated herein as fully as though set forth in full.

2.

That, for the period from October 1, 1936 to September 30, 1938, said corporation paid to the said defendant any and all manufacturer's excise taxes due to the said defendant or to the United States

of America under Section 606 (c) of the 1932 Revenue Act. That subsequently, the defendant, acting under the instructions of the Commissioner of Internal Revenue, notified the corporation that it was liable for a further assessment under the provision of the said section of said Act in the sum of \$78.96. That, thereafter, acting under the authority of the Commissioner of Internal Revenue, the defendant required the corporation to and it did pay to the defendant the above set forth sum as follows:

Date of Payments	Amount
November 16, 1936.....	\$ 4.66
December 15, 1936.....	3.77
January 15, 1937.....	3.15

[5]

February 19, 1937.....	2.11
March 26, 1937.....	2.49
April 28, 1937.....	3.23
May 28, 1937.....	2.78
June 30, 1937.....	4.74
July 28, 1937.....	5.36
August 28, 1937.....	5.15
September 30, 1937.....	6.14
October 29, 1937.....	5.77
November 24, 1937.....	4.51
December 29, 1937.....	3.24
January 29, 1938.....	2.25
February 28, 1938.....	2.39
March 25, 1938.....	1.15
April 30, 1938.....	1.61
May 25, 1938.....	3.36
June 20, 1938.....	3.52
July 22, 1938.....	1.71
August 24, 1938.....	2.00
September 29, 1938.....	1.54
October 29, 1938.....	2.34

\$78.96

That on or about February 17, 1940, plaintiffs duly filed with the defendant for transmission to the Commissioner of Internal Revenue a claim for refund and repayment of said amount, a full, true and correct copy of which claim is attached hereto, marked Exhibit "G" and is by this reference made a part hereof and incorporated herein as fully as though set forth in full. That thereafter, under date of April 18, 1940, the Commissioner of Internal Revenue, in writing, notified the corporation that such claim was disallowed and rejected, a copy of which letter is attached hereto, marked Exhibit "B" and is by this reference made a part hereof and incorporated herein as fully as though set forth herein.

3.

As paragraph 3, plaintiffs refer to paragraph 6 of its first cause of action, and by this reference incorporate the same herein as fully as though set forth herein in full.

Wherefore, plaintiffs pray for judgment against the defendant in the sum of \$1,228.96, together with interest thereon after the 17th day of February, 1940, from and after the respective dates of payment as listed in the schedules attached to Exhibits "A" and "E" herein at the rate of 6% per annum until paid; plaintiffs further pray for judgment against the defendant in the sum [6] of \$1,057.92, together with interest thereon from and after the 11th day of April, 1940, at the rate of

6% per annum until paid, together with its costs and disbursements herein.

GEORGE KINNEAR

Of Counsel for Plaintiff. [7]

EXHIBIT "A"

Form 843

Treasury Department

Internal Revenue Service

Revised June 1930

AMENDED CLAIM

CLAIM

To Be Filed with the Collector Where Assessment Was Made or Tax Paid.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Refund of Tax Illegally Collected.

Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

Abatement of Tax Assessed (not applicable to estate or income taxes).

Collector's Stamp. (Date received)

State of Washington,
County of King—ss.

(Type or Print)

Name of taxpayer or purchaser of stamps—Con-Rod Exchange, Inc.

Business address—812 East Pike Street, Seattle, Washington.

Residence

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—Washington (at Tacoma)

2. Period (if for income tax, make separate form for each taxable year) from 6-21, 1932, to 9-30, 1935.

3. Character of assessment or tax—Manufacturers' Excise Tax

4. Amount of assessment, \$2,019.14; dates of payment—See Attached Sheet

5. Date stamps were purchased from the Government—

6. Amount to be refunded—\$1,150.00.

7. Amount to be abated (not applicable to income or estate taxes)—

8. The time within which this claim may be legally filed expires, under Section 3312 (a) of the Revenue Act of 19..., on Sept. 25, 1941, and subsequent thereto:

The deponent verily believes that this claim should be allowed for the following reasons:

This claim of refund is based upon the opinion of Yankwich, D.J., in the case of Con-Rod Exchange, Inc. (this taxpayer) v. Henricksen, a copy of which is attached hereto. The sales upon which

the manufacturers' tax was assessed in the period above set forth were sales of rebabbitted conrods and were of exactly the same nature as the sales upon which taxes were assessed for the period from Oct. 1, 1935, to August 31, 1936, which were considered by Yankwich, D.J., in the opinion just mentioned.

Judgment was rendered for the plaintiff in the above-entitled case, claimant herein, on the 30th day of August, 1939. The case was tried in the Western District, Southern Division, of Washington.

Claimant further states with particular reference to the statement above that "the sales * * * were of exactly the same nature as the sales upon which taxes were assessed for the period from Oct. 1, 1935, to August 31, 1936, which were considered by Yankwich, D.J." (not as an addition thereto but for the purpose of being more specific) that "the burden of said taxes was borne solely and exclusively by the plaintiff and the burden of none of said taxes was passed on by the plaintiff to its customers or vendees either as a separate item or as a portion of the sales price" (quoted from Findings of Fact of above cited case). The property of the original statement is supported by *Pink vs. United States*, 105 F (d) 183.

As to the contention that claimant's business was one subject to a manufacturers' excise tax, it is claimant's position that the judgment rendered for claimant, as above set forth is *res adjudicata*.

New Orleans v. Citizens Bank, 167 U. S. 371,
42 L. Ed 202;

Pink v. U. S. 38-1 U.S.T.C. 9402; (Appealed
on other issues) 105 F (d) 183;
Tait v. Western Maryland Ry. 289 U. S. 620;
77 L. Ed. 1405.

Claimant requests further consideration of its
claim

(Signed) CON-ROD EXCHANGE, INC.

.....

President

Sworn to and subscribed before me this 17 day
of February 1940.

.....

Notary Public.

(See Instructions on Reverse Side)

CERTIFICATE

I certify that an examination of the records of
this office shows the following facts as to the assess-
ment and payment of the tax: Character of assess-
ment and period covered, List, Year, Month.

Account No. or Page, Line, Amount assessed
\$. Total, \$.

Paid, Abated, or Credited, Date, Amount, \$.
Total, \$.

Claim No.

I certify that the records of this office show the
following facts as to the purchase of stamps: To
Whom Sold or Issued, Kind, Number, Denomina-
tion, Date of sale or issue, Amount \$.

If special tax stamp, state: Serial number, Period
commencing—

.....

Collector of Internal Revenue

.....

(District)

Claim examined by.....

Claim approved by.....

Chief of Division.

Amount claimed.. \$.

Amount allowed.. \$.

Amount rejected.. \$.

Committee on Claims

.....

.....

.....

Instructions

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

Date of Payments	Amount
September 25, 1937.....	\$50.00
October 25, 1937.....	50.00
November 26, 1937.....	50.00
December 27, 1937.....	50.00
January 25, 1938.....	50.00
February 25, 1938.....	50.00
March 25, 1938.....	50.00
May 5, 1938.....	50.00
May 25, 1938.....	50.00
June 24, 1938.....	50.00
July 25, 1938.....	50.00
August 25, 1938.....	50.00
September 25, 1938.....	50.00
October 25, 1938.....	50.00

Date of Payments	Amount
November 26, 1938.....	50.00
December 29, 1938.....	50.00
January 25, 1939.....	50.00
February 25, 1939.....	50.00
April 5, 1939.....	50.00
April 25, 1939.....	50.00
May 23, 1939.....	50.00
June 23, 1939.....	50.00
July 28, 1939.....	50.00
	<hr/>
	\$1,150.00

EXHIBIT "B"

TREASURY DEPARTMENT

Washington

Office of Commissioner
of Internal Revenue
MT:ST:JNG

Apr. 18, 1940

Con-Rod Exchange, Inc.,
812 East Pike Street,
Seattle, Washington.

Gentlemen:

Reference is made to your claims for the refund of \$1,150.00 and \$78.97, representing tax, penalty and interest paid under the provisions of section 606 (c) of the Revenue Act of 1932, for the periods June 21, 1932 to September 30, 1935, and October 1, 1936 to September 30, 1938, respectively.

The claims are based on the contention that tax

was erroneously paid on sales of rebabbitted connecting rods. In this connection you have cited the decision rendered August 17, 1939 in your favor by the United States District Court for the Western District of Washington, Southern Division. This decision covers manufacturer's excise tax paid for the period October 1, 1935 to August 1, 1936, inclusive.

This office takes the position that a person who produces connecting rods, etc. from used or scrap material or from both new and used material by a manufacturing process which produces serviceable articles is subject to the manufacturer's excise tax imposed by section 606 (c) of the Revenue Act of 1932 on his sales thereof. A case on this point which supports the Bureau's position and declines to follow the decision referred to above is *Clawson and Bals, Inc., Plaintiff-Appellant, v. Collector of Internal Revenue, Defendant-Appellee*, decided in the United States Circuit Court of Appeals for the Seventh Circuit on December 13, 1939. The United States Supreme Court denied certiorari in this case April 8, 1940.

These claims cover the identical periods and payments of tax as claims S-78721 and 78723, which were rejected February 1, 1940, therefore, they are duplicate claims.

In view of the foregoing, the claims are rejected in full.

Your attention is invited to the fact that regardless of the foregoing, no allowance could be made

with respect to your claims in view of section 621 (d) of the Revenue Act of 1932, which prohibits the Commissioner from allowing a refund of overpayments of tax under Title IV of the Revenue Act of 1932 unless the person claiming the refund establishes that he has neither passed the tax on to his customers as a separate item nor included it in the selling price of his product, or, if he has passed the tax on to his customers as a separate item or included it in his selling price, that he has either refunded the amount of the tax to the ultimate purchaser or has received the written consent of each ultimate purchaser to the allowance of the refund.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (D. S. Bliss)

D. S. BLISS

Deputy Commissioner.

cc-Tacoma, Wash.

EXHIBIT "C"

In the District Court of the United States for the
Western District of Washington, Northern
Division

No. 8570

CON-ROD EXCHANGE, INC., a corporation,
Plaintiff,

vs.

THOR W. HENRICKSEN, Acting Collector of In-
ternal Revenue,

Defendant.

FINDINGS OF FACT AND CONCLUSIONS
OF LAW

The above-entitled cause came on regularly for trial on the 9th day of August, 1939 before the above-entitled court, Honorable Leon R. Yankwich presiding therein, sitting without a jury.

Plaintiff appeared by its attorneys, Jones & Bronson, and was represented in Court by Mr. H. B. Jones and Mr. George Kinnear, and the defendant appeared by its attorneys, Mr. J. Charles Dennis and Mr. Oliver Malm, United States Attorneys, and was represented in Court by Mr. Thomas S. Winter, Deputy United States Attorney.

Witnesses were sworn and testimony given at the said hearing, and the Court being fully advised in the facts and the law, makes its

FINDINGS OF FACT:

Finds that all of the allegations of plaintiff's complaint are true.

Finds that all of the allegations contained in the second defense of defendant's answer are untrue.

And more particularly, the Court finds:

I.

That the plaintiff, Con-Rod Exchange, Inc., at all times hereinafter mentioned, was and now is, a corporation, organized, existing and doing business under and by virtue of the laws of the State of Washington, and that it has paid all fees due the [8] State of Washington, including the license fee last past due. That its principal place of business is within the judicial district of the above-entitled Court. That it is a citizen of the United States; and that it has at all times borne true allegiance to the Government of the United States, and that it has not in any way voluntarily aided, abetted or given encouragement to rebellion against said United States.

II.

That the defendant at all times hereinafter mentioned and since the 11th day of July, 1936, was and still is the Acting Collector of Internal Revenue of the United States for the Collection District of Washington, having an office and residing at Tacoma, Pierce County, within the above-entitled district, and that said defendant now is a

citizen of the State of Washington, Pierce County therein.

III.

That on or about April 27, 1937 the defendant, acting under the instruction of the Commissioner of Internal Revenue, determined that the plaintiff was liable for a further assessment of taxes under the provisions of Section 606 (c) of the Revenue Act of 1932, said assessment being for excise taxes upon the sale by plaintiff of certain automobile parts or accessories, to-wit: connecting rods and armatures and starting rods. The additional assessment was in the sum of \$234.84 and \$11.74 penalty. Thereafter, acting under the authority of the Commissioner of Internal Revenue, the defendant, on the 26th day of August, 1937, required the plaintiff to, and thereupon it did, pay to the defendant the above stated sums, together with interest thereon of \$8.22, or a total payment of \$254.80.

This assessment of excise taxes collected from the plaintiff, as set forth in the preceding paragraph, was with respect to sales of automobile connecting rods and armatures, as stated heretofore, sold by plaintiff during the period from October 1, 1935 to August 31, 1936. \$11.52 of the assessment represented [9] additional assessment of excise tax and penalty upon the sale of armatures and starting rods and \$235.06 represented an additional assessment of excise tax and penalty upon the sale of connecting rods.

IV.

That on or about August 27, 1937 plaintiff duly filed with the defendant, for transmission to the Commissioner of Internal Revenue, its claim for refund of the aforesaid excise taxes and interest and penalty assessed against and collected from the plaintiff, as hereinbefore set forth, in the aggregate amount of \$254.80. This claim was made and duly filed upon the official form prescribed therefor by the Treasury Department of the United States and was so filed within four years after the date of payment of said taxes, and said claim set forth the reasons for and the ground supporting the refund for said taxes.

V.

Thereafter, under the date of November 10, 1937, the Honorable Guy T. Helvering, Commissioner of Internal Revenue, acting by and through the Honorable D. S. Bliss, Deputy Commissioner of Internal Revenue, rejected and disallowed said claim for refund, basing this rejection upon the merits of the claim, notified the plaintiff of such rejection and disallowance by letter dated November 10, 1937, signed by said Deputy Commissioner.

VI.

The plaintiff did not include the aforesaid excise taxes in the price of the articles with respect to which said taxes were imposed; and plaintiff did not collect the amount of said taxes, or any part thereof, from the vendee or vendees of the articles

in respect of which said taxes were imposed. The burden of said taxes was borne solely and exclusively by the plaintiff and the burden of none of said taxes was passed on by the plaintiff to its customers or vendees.

VII.

The largest part of the aforesaid excise taxes were [10] assessed and imposed in respect of sales by plaintiff of rebabbitted connecting rods. For the most part all of said connecting rods were originally manufactured by persons, firms or corporations other than plaintiff and before their acquisition by plaintiff had been used as operating parts of automobile motors, and by reason of such use the babbitt metal bearings constituting parts of said rods were worn, chipped, roughened and otherwise impaired. These rods were acquired by plaintiff from various wrecking houses throughout the country or from individuals bringing in used rods from their own automobiles for the purpose of having the said babbitt bearings replaced.

In some few instances where new car models were placed upon the market with entirely different types or sizes of connecting rods the plaintiff would purchase a limited supply of new connecting rods from automobile manufacturers or dealers. In these cases it was merely acting as an ordinary jobber when making sales to its customers.

VIII.

Plaintiff imported none of said connecting rods in respect of which said excise taxes were assessed,

but obtained all thereof from sources within the United States. At no time has plaintiff imported, nor does it now import, any automobile parts or accessories whatsoever.

IX.

The rebabbitting consisted in applying a metal alloy to the inside and edges of the bearing formed by the detachable cap and the large end of the shank of the rod. The method of doing the work was, in substance, this: Plaintiff purchased shanks from wrecking houses, either in Seattle or elsewhere, to establish a stock in a particular type of connecting rod. After a stock was once established, individual customers would bring in used shanks for rebabbitting. If the plaintiff had in stock a rebabbitted connecting rod of the same size and type as the customer's, it was given in exchange to the particular customer. In the case [11] of new automobile models, with new types of connecting rods, the plaintiff would purchase some new connecting rods from the automobile manufacturers. To rebabbitt the rod a used forging or shank, after the cap and the shank had been separated, was placed in a container of hot babbitt, which would melt off and dissolve the old babbitt still adhering to the old forging. The forging was then placed in an acid solution which cleaned off all grease and dirt. Then the new alloy was applied to the bearing by pouring, after which the surface of the new babbitt was evened so that the cap and the shank would fit

together again. The inside of the new babbitted bearing was rough-bored to a size slightly smaller than what was to become the finished diameter, then a broaching occurred, which, finally, resulted in providing the prescribed diameters. The connecting rods were then placed in plaintiff's stock.

The used connecting rod consisted primarily of a forging formed by a shank and cap fastened together by bolts, which formed an opening constituting the bearing intended to contain a babbitted surface. The babbitt metal bearings contained in the connecting rods involved in this suit were of inconsequential size and bulk compared with the total size and bulk of the connecting rods, the babbitted surface being but approximately one-sixteenth of an inch or less in thickness.

A rebabbitted connecting rod is a secondhand connecting rod; and all of the connecting rods which were rebabbitted by plaintiff, and in respect of which the taxes involved in this case were imposed, were secondhand connecting rods when sold by plaintiff after the same were rebabbitted. The price for which they were sold was less than that charged for new connecting rods.

X.

The connecting rods which were rebabbitted by plaintiff, and in respect of which the excise taxes involved in this suit were imposed, did not lose their identity as connecting rods [12] during, or as a result of, the rebabbling process in plaintiff's shop.

There is no change in shape or identity of the rod following the rebabbitting. The dimensions remain the same. The only new part is a thin layer of metal alloy applied to the bearing, smoothed out and the edges evened, so that the bearing will have the holding quality which had been lost in the old one through the wearing off of the old babbitt. The function of the shank is still the same. The result achieved is less of a structural change than takes place when old armatures are rewound.

None of the identifying symbols, trade-marks, number or other identifying data appearing on said connecting rods were moved, marred or obliterated during, or as a result of, the rebabbitting process in plaintiff's shop, but on the contrary, all such identifying numbers and data were left intact.

XI.

Plaintiff's books and records show that seventy-five per cent. (75%) or more of its sales of rebabbitted connecting rods were sales of rods brought in by customers wherein the same rods were rebabbitted and returned. The defendant does not argue that these are other than repair jobs.

A certain amount of the sales made, shown by the plaintiff's books to be not more than twenty-five per cent. (25%) of the total sales, were of an exchange nature. Where possible plaintiff maintained a stock of rebabbitted rods upon its shelves of various kinds and makes. This was a matter of convenience to the plaintiff and its customers so

that the latter, by exchanging their old, used rods for rebabbitted rods and paying a consideration in cash for the rebabbitting, could obtain prompt delivery of rebabbitted rods without waiting for the actual rebabbitting process to be completed upon the customers' own rods. That not more than 25% of the additional tax applied to exchange sales. [13]

XII.

The rebabbitting process performed by plaintiff upon the connecting rods in respect of which the excise taxes involved in this case were imposed constituted the repair, rehabilitation or reconditioning of used and secondhand connecting rods, and did not constitute the manufacture or production of connecting rods.

XIII.

During the period of time involved in this case—namely, October 1, 1935 to August 31, 1936, the plaintiff engaged in no rewinding or processing or repairing of armatures or processing or repairing of starting rods whatsoever and has not carried on any such business subsequent to 1934.

XIV.

The plaintiff at no time manufactured, produced or imported any automobile parts or accessories whatsoever. The sales of rebabbitted connecting rods with respect of which the largest part of the excise taxes involved in this case was imposed, did not constitute the sales of automobile parts or ac-

cessories by a manufacturer, producer or importer in any instance.

Dated this 30th day of August, 1939.

LEON R. YANKWICH,

United States District Judge

Presented by:

GEORGE KINNEAR

Of Attorneys for Plaintiff

From the foregoing Findings of Fact, the Court makes and enters the following

CONCLUSIONS OF LAW:

I.

The plaintiff has complied with all statutory conditions constituting conditions precedent to the institution and main- [14] tenance of this suit.

II.

That plaintiff is not, and was not during the times involved in this suit, the manufacturer, producer or importer of automobile connecting rods or of any automobile parts or accessories whatsoever within the meaning of Section 606 of the Revenue Act of 1932. The tax imposed by Section 606 (c) of the Revenue Act of 1932 applies only to sales of automobile parts or accessories when sold by the manufacturer, producer or importer.

III.

The excise tax imposed by Section 606(c) of the Revenue Act of 1932 does not apply to sales of re-

babbitted automobile connecting rods by one who acquires such rods secondhand and rebabbitts the same, and who neither manufactures, produces nor imports any other automobile parts or accessories.

IV.

In holding and determining that the tax imposed by Section 606(c) of the Revenue Act of 1932 applied to sales of rebabbitted connecting rods, re-wound armatures and repaired starting rods by plaintiff during the period from October 1, 1935 to August 31, 1936, the Commissioner of Internal Revenue has exceeded the authority granted him under the Internal Revenue Act of 1932.

V.

Under the evidence and the law the plaintiff is entitled to judgment against defendant in the sum of Two Hundred Fifty-four and 80/100 (\$254.80) Dollars, together with interest thereon from August 26, 1937 at the rate of six per cent. (6%) per annum, and together with plaintiff's costs and disbursements, as provided by law.

Dated this 30th day of August, 1939.

LEON R. YANKWICH

United States District Judge.

Presented by:

GEORGE KINNEAR

Of Attorneys for Plaintiff. [15]

EXHIBIT "D"

In the District Court of the United States for the
Western District of Washington, Northern
Division

No. 8570

CON-ROD EXCHANGE, INC., a corporation,
Plaintiff,

vs.

THOR W. HENRICKSEN, Acting Collector of
Internal Revenue,
Defendant.

JUDGMENT

The above-entitled cause came on regularly for trial on the 9th day of August, 1939 before the above-entitled Court, Honorable Leon R. Yankwich presiding therein, sitting without a jury.

Plaintiff appeared by its attorneys, Jones & Bronson, and was represented in Court by Mr. H. B. Jones and Mr. George Kinnear, and the defendant appeared by its attorneys, Mr. J. Charles Dennis and Mr. Oliver Malm, United States Attorneys, and was represented in Court by Mr. Thomas S. Winter, Representative of the Chief Counsel, Bureau of Internal Revenue.

Witnesses were sworn and testimony given at the said hearing, and the Court being fully advised in the facts and the law, and having made and entered its Findings of Fact and Conclusions of Law herein,

Now, Therefore, it is Ordered, Adjudged and Decreed that plaintiff have and recover judgment against the defendant in the sum of Two Hundred Fifty-four and 80/100 (\$254.80) Dollars, together with interest thereon from August 26, 1937 at the rate of 6% per annum, and together with plaintiff's costs and disbursements to be taxed, as provided by law.

Dated this 30th day of August, 1939.

LEON R. YANKWICH

United States District Judge.

Presented by:

GEORGE KINNEAR

Of Attorneys for Plaintiff. [16]

I, Leon R. Yankwich, District Judge of the United States, and sitting in the District Court of the United States for the Western District of Washington, on this 30th day of August, 1939, do hereby certify:

That the acts done by the defendant in the above entitled case, as the Collector of Internal Revenue, in imposing and assessing and exacting and collecting the said excise tax, in the amount of \$254.80, comprising \$234.84 tax, plus \$11.74 penalty and \$8.22 interest, as set forth in the foregoing judgment, were done in his official capacity as such Collector of Internal Revenue, and the said Thor W. Henricksen had probable cause for his acts, notwithstanding the fact that a part of said tax was

erroneously collected, and judgment has been rendered for a refund thereof in this case.

Dated this 30th day of August, 1939.

LEON R. YANKWICH,

United States District Judge. [17]

EXHIBIT "E"

Form 843

Treasury Department
Internal Revenue Service
Revised June 1930

CLAIM

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Refund of Tax Illegally Collected.

Refund of Amount Paid for Stamps Unused, or
Used in Error or Excess.

Abatement of Tax Assessed (not applicable to
estate or income taxes).

Collector's Stamp (Date received)

State of Washington,
County of King—ss.

(Type or Print)

Name of taxpayer or purchaser of stamps—Con-
Rod Exchange, Inc.

Business address—812 East Pike Street, Seattle, Washington

Residence—

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—Washington (at Tacoma)

2. Period (if for income tax, make separate form for each taxable year) from 6-21, 1932, to 9-30, 1935

3. Character of assessment or tax—Manufacturers' Excise Tax

4. Amount of assessment, \$1057.92 (\$869.64 assessed—\$188.28 int. thereon. Paid 3/23/40

5. Date stamps were purchased from the Government—

6. Amount to be refunded—\$1057.92

7. Amount to be abated (not applicable to income or estate taxes)—

8. The time within which this claim may be legally filed expires, under Section 3313 IRC, on March 21, 1944.

The deponent verily believes that this claim should be allowed for the following reasons:

The tax assessed and paid, the refund of which is hereby being asked, was manufacturers' excise tax for the period of 6-21-32 to 9-30-35. It was assessed upon sales of rebabbitted Con-Rods. These Con-Rods were exactly the same character as those

sold by this taxpayer during the period from October 1, 1935 to August 1, 1936. The nature of the entire transactions of sale were also the same. The assessment of tax upon this type of sale as made by this taxpayer for the earlier period was considered by Yankwich, D. J., in the Western District, Southern Division of Washington. The said court held these sales not to be subject to the manufacturers excise tax and rendered judgment for the plaintiff on the 30th day of August, 1939, in accordance with a written opinion, a copy of which was previously filed with the Collector of Internal Revenue on or about February 16, 1940. This claim is based upon the said opinion and judgment.

Claimant further states with particular reference to the statement above that "the nature of the entire transactions of sale were also the same" as those passed on by the District Court (not as an addition thereto but for the purpose of being more specific) that "the burden of said taxes was borne solely and exclusively by the plaintiff and the burden of none of said taxes was passed on by the plaintiff to its customers or vendees either as a separate item or as a portion of the sales price" (quoted from Findings of Fact of above cited case). The propriety of the original statement is supported by *Pink v. United States*, 105 F (2) 183.

Claimant basis its position further on the ground that the judgment rendered for it as above set forth is *res adjudicata* as to the issues involved therein,

these being the same as those relating to the present claim of refund.

New Orleans v. Citizens Bank, 167 U. S. 371,
42 L. Ed. 202;

Pink v. U. S. 38-1 U.S.T.C. 9402; (Appealed
on other issues) 105 F (2d) 183;

Tait v. Western Maryland Rwy. 289 U. S.
620; 77 L. Ed. 1405. [18]

(Signed) CON-ROD EXCHANGE, INC.
By RUTRARD SEWARD
President

Sworn to and subscribed before me this 10 day
of April, 1940.

E. A. NIEMEIER
Notary Public

(See Instructions on Reverse Side)

CERTIFICATE

I certify that an examination of the records of
this office shows the following facts as to the assess-
ment and payment of the tax: Character of assess-
ment and period covered, List, Year, Month. Ac-
count No. or Page, Line. Amount assessed \$.
Total, \$.

Paid, Abated, or Credited, Date, Amount, \$.
Total, \$.

Claim No.

I certify that the records of this office show the
following facts as to the purchase of stamps:

To Whom Sold or Issued, Kind, Number, De-
nomination, Date or sale or issue, Amount \$.

If special tax stamp, state: Serial number, Period commencing—

.....

Collector of Internal Revenue.

.....

(District)

Claim examined by—.....

Claim approved by—.....

Chief of Division.

Amount claimed.. \$.....

Amount allowed.. \$.....

Amount rejected.. \$.....

Committee on Claims

.....

.....

.....

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

EXHIBIT "F"

TREASURY DEPARTMENT

Washington

Office of Commissioner

of Internal Revenue

MT:ST:JNG

Cl. S-84499

Jul 31 1940

Con-Rod Exchange, Inc.,
812 East Pike Street,
Seattle, Washington.

Gentlemen:

Reference is made to your claim for the refund of \$1,057.92, representing tax, penalty and interest paid under the provisions of section 606(c) of the Revenue Act of 1932, for the period June 21, 1932 to September 30, 1935, inclusive.

The claim is based on the contention that tax was erroneously paid on sales of rebabbited connecting rods. In this connection you have cited the decision rendered in your favor on August 17, 1939 by the United States District Court for the Western District of Washington, Southern Division. This decision covers manufacturer's excise tax paid for the period October 1, 1935 to August 1, 1936, inclusive.

This office takes the position that a person who produces connecting rods, etc. from used or scrap material or from both new and used material by a manufacturing process which produces serviceable

articles is subject to the manufacturer's excise tax imposed by section 606(c) of the Revenue Act of 1932 on his sales thereof. A case on this point which supports the Bureau's position and declines to follow the decision referred to above is *Clawson and Bals, Inc., Plaintiff-Appellant, v. Collector of Internal Revenue, Defendant-Appellee*, decided in the United States Circuit Court of Appeals for the Seventh Circuit on December 13, 1939. The United States Supreme Court denied certiorari in this case April 8, 1940.

In view of the foregoing the claim is rejected in full.

Your attention is invited to the fact that regardless of the foregoing, no allowance could be made with respect to your claim, in view of the section 3443(d) of the Internal Revenue Code, which prohibits the Commissioner from allowing a refund of overpayments of tax under Title IV of the Revenue Act of 1932, unless the person claiming the refund establishes that he has neither passed the tax on to his customers as a separate item nor included it in the selling price of his product, or, if he has passed the tax on to his customers as a separate [19] item or included it in his selling price, that he has either refunded the amount of the tax to the ultimate purchasers or has received the written consent of each ultimate purchaser to the allowance of the refund.

Respectfully,

GUY T. HELVERING,
Commissioner.

By:

(D. S. Bliss)

. D. S. BLISS,

Deputy Commissioner.

cc-Tacoma, Washington. [20]

EXHIBIT "G"

Form 843

Treasury Department

Internal Revenue Service

Revised June 1930

AMENDED CLAIM

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the
kind of claim filed, and fill in the certificate on the
reverse side.

Refund of Tax Illegally Collected.

Refund of Amount Paid for Stamps Unused, or
Used in Error or Excess.

Abatement of Tax Assessed (not applicable to
estate or income taxes).

Collector's Stamp (Date received)

State of Washington,
County of King—ss.

Type or Print

Name of taxpayer or purchaser of stamps—Con-
Rod Exchange, Inc.

Business address—812 East Pike Street, Seattle, Washington.

Residence—

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—Washington (at Tacoma)

2. Period (if for income tax, make separate form for each taxable year) from 10-1-36 to 9-30-38.

3. Character of assessment or tax—Manufacturers' Excise Tax

4. Amount of assessment, \$78.96; dates of payment—See Attached Sheet

5. Date stamps were purchased from the Government—

6. Amount to be refunded—\$78.96

7. Amount to be abated (not applicable to income or estate taxes)—

8. The time within which this claim may be legally filed expires, under Section 3312 (a) IRC on October 1, 1940 and subsequent thereto:

The deponent verily believes that this claim should be allowed for the following reasons:

The tax assessed and paid, the refund of which is hereby being asked, was manufacturers excise tax paid monthly during the period set forth above. It was assessed upon sales of rebabbitted Con-Rods. These Con-Rods were exactly the same character as those sold by this taxpayer during the period

from October 1, 1935 to August 1, 1936. The nature of the entire transactions of sale were also the same. The assessment of tax upon this type of sale as made by this taxpayer for the earlier period was considered by Yankwich, D. J., in the Western District, Southern Division of Washington. The said court held these sales not to be subject to the manufacturers excise tax and rendered judgment for the plaintiff on the 30th day of August 1939 in accordance with a written opinion, a copy of which is attached to a separate claim of refund filed this day by this taxpayer. This claim is based upon the said opinion and judgment.

Claimant further states with particular reference to the statement above that "the nature of the entire transactions of sale were also the same" as those passed on by the District Court (not as an addition thereto but for the purpose of being more specific) that "the burden of said taxes was borne solely and exclusively by the plaintiff and the burden of none of said taxes was passed on by the plaintiff to its customers or vendees either as a separate item or as a portion of the sales price" (quoted from Findings of Fact of above cited case). The propriety of the original statement is supported by *Pink v. United States* 105 F (2) 183.

As to the contention that claimant's business was one subject to a manufacturer's excise tax, it is claimant's position that the judgment rendered for claimant, as above set forth, is *res adjudicata*.

New Orleans v. Citizens Bank, 167 U.S. 371,
42 L. Ed. 202;

Pink v. U. S. 38-1 U.S.T.C. 9402; (Appealed
on other issues) 105 F (2) 183;

Tait v. Western Maryland Rw. 289 U. S. 620;
77 L. Ed. 1405.

Claimant requests further consideration of its
claim. [21]

(Signed) CON-ROD EXCHANGE, INC.

.....

President

Sworn to and subscribed before me this day
of February, 1940.

.....

Notary Public.

(See Instructions on Reverse Side)

CERTIFICATE

I certify that an examination of the records of
this office shows the following facts as to the assess-
ment and payment of the tax: Character of assess-
ment and period covered, List, Year, Month.

Account No. or Page, Line, Amount assessed
\$. Total, \$.

Paid, Abated, or Credited, Date, Amount, \$.
Total, \$.

Claim No.

I certify that the records of this office show the
following facts as to the purchase of stamps: To
Whom Sold or Issued, Kind, Number, Denomina-
tion, Date of sale or issue, Amount \$.

If special tax stamp, state: Serial number, Period
commencing—

.....

Collector of Internal Revenue

.....

(District)

Claim examined by.....

Claim approved by.....

Chief of Division.

Amount claimed.. \$.

Amount allowed.. \$.

Amount rejected.. \$.

Committee on Claims

.....

.....

.....

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy

collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name followed by the signature and title of the officer having authority to sign for the corporation.

November 16, 1936.....	\$ 4.66
December 15, 1936.....	3.77
January 15, 1937.....	3.15
February 19, 1937.....	2.11
March 26, 1937.....	2.49
April 28, 1937.....	3.23
May 28, 1937.....	2.78
June 30, 1937.....	4.74
July 28, 1937.....	5.36
August 28, 1937.....	5.15
September 30, 1937.....	6.14
October 29, 1937.....	5.77
November 24, 1937.....	4.51
December 29, 1937.....	3.24

January 29, 1938.....	2.25
February 28, 1938.....	2.39
March 25, 1938.....	1.15
April 30, 1938.....	1.61
May 25, 1938.....	3.36
June 20, 1938.....	3.52
July 22, 1938.....	1.71
August 24, 1938.....	2.00
September 29, 1938.....	1.54
October 29, 1938.....	2.34

\$78.96

[Endorsed]: Filed Sept. 28, 1940. [22]

[Title of District Court and Cause.]

ANSWER

Comes now the defendant by J. Charles Dennis, and Frank Hale, United States Attorney and Assistant United States Attorney, respectively, for the Western District of Washington and in answer to plaintiff's alleged first cause of action, admits, denies and alleges as follows:

I.

Answering Paragraph I defendant admits the allegations therein contained except defendant denies that the plaintiff was fully entitled to the amount herein claimed from the United States and that no assignment or transfer of said claim or any part thereof or any interest therein has been made.

II.

Defendant admits the allegations contained in Paragraph II.

III.

Answering Paragraph III, defendant admits that the Con-Rod Exchange, Inc. paid the total sum of \$1,150.00 to the defendant as Acting Collector of Internal Revenue as taxes assessed against said corporation under the provisions of Section 606 (c) of the Revenue Act of 1932 in the amounts [23] therein alleged except defendant alleges there are slight discrepancies as to the dates of payment thereof and demands strict proof thereof; defendant also admits that the claim for refund was filed on February 21, 1930, and not on February 17, 1940, as alleged and that said claim for refund was disallowed and rejected under date of April 18, 1940, but defendant denies each and every other allegation in said paragraph.

IV.

Answering Paragraph IV, defendant denies each and every allegation therein contained and further answering said paragraph alleges that the Con-Rod Exchange, Inc., at all times therein mentioned was a corporation engaged in the manufacture and/or producer of articles sold by it within the provisions of Section 606 (c) of the Revenue Act of 1932 and Regulations promulgated thereunder and upon which the assessments were levied and the tax paid.

V.

Defendant denies the allegations contained in Paragraph V.

VI.

Answering Paragraph VI, defendant admits that on August 9, 1939, a trial was had before the above-entitled court of an action by the Con-Rod Exchange, Inc. against this defendant in which a refund of manufacturer's excise taxes was sought; that the said taxes which had been paid by the corporation were paid for the period from October 1, 1935, to August 31, 1936; that the said court made and entered Findings of Fact and Conclusions of Law upon the 30th day of August, 1939, which are attached to plaintiff's complaint; that upon the same date, namely the 30th day of August, 1939, the said court ordered judgment for the [24] corporation, a copy of which judgment is also attached to plaintiff's complaint but defendant denies each and every other allegation in said paragraph.

Further answering said paragraph, defendant alleges that the said judgment is not unreversed and unmodified and in full force and effect and that the matters set forth in Paragraph I to V, inclusive, which were determined, adjudged and decreed and said decree is not *res judicata*. Defendant further alleges that the decision of the Circuit Court of Appeals for the Ninth Circuit in the case of *United States v. Armature Exchange*, 116 Fed. (2d) 969 is conclusive and binding as regards the instant case.

Defendant, in answer to plaintiff's alleged second cause of action admits, denies and alleges as follows:

I.

Answering Paragraph I, defendant refers to Paragraphs I, II, IV, V and VI of his answer to plaintiff's alleged first cause of action and by this reference incorporates the same herein as if set out *hoc verba*.

II.

Answering Paragraph II, defendant admits that the Con-Rod Exchange, Inc. paid the sum of \$1,057.92 as alleged to the defendant as Acting Collector of Internal Revenue covering taxes assessed against the said corporation under the provisions of Section 606 (c) of the Revenue Act of 1932 and Regulations promulgated thereunder; that the claim for refund was filed on April 11, 1940, and that the said claim for refund was disallowed and rejected under date of July 31, 1940, but defendant denies each and every other allegation in said paragraph. [25]

Defendant, in answer to plaintiff's alleged third cause of action, admits, denies and alleges as follows:

I.

Defendant refers to Paragraphs I, II, IV and V of his answer to plaintiff's alleged first cause of action and by this reference incorporates the same herein as if set out *hoc verba*.

II.

Answering Paragraph II, defendant admits that the Con-Rod Exchange, Inc. paid the total sum of \$78.96 to the defendant as Acting Collector of Internal Revenue covering taxes assessed against the

said corporation under the provisions of Section 606 (c) of the Revenue Act of 1932 and Regulations promulgated thereunder in the amounts therein alleged except defendant alleges that there are slight discrepancies as to the dates of payment thereof and demand strict proof; defendant also admits that the claim for refund was filed on February 21, 1940, and not on February 17, 1940, as alleged, and that the said claim for refund was disallowed and rejected under date of April 18, 1940, but defendant denies each and every other allegation in said paragraph.

III.

Answering Paragraph III, defendant refers to Paragraph VI of his answer to plaintiff's alleged first cause of action and by this reference incorporates the same herein as if set out *hoc verba*.

Wherefore, defendant, having fully answered the plaintiff's alleged first, second and third causes of action, prays that those actions be dismissed with costs to the [26] defendant.

J. CHAS. DENNIS

United States Attorney

FRANK HALE

Ass't United States Attorney

THOMAS R. WINTER

General Counsel Representative

Copy received Apr. 11, 1941.

JONES & BRONSON

Attorneys for Pltf.

[Endorsed]: Filed Apr. 12, 1941. [27]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause came on regularly for trial on the 13th day of January, 1942, before the above-entitled Court, Honorable Lewis B. Schwel-lenbach presiding therein, sitting without a jury.

Plaintiffs appeared by their attorneys, Jones & Bronson, and were represented in Court by Mr. H. B. Jones and Mr. R. B. Hooper, and the defendant appeared by his attorneys, Mr. J. Charles Dennis and Frank Hale, United States Attorneys, and was represented in Court by Mr. Thomas R. Winter, Special Assistant to the Chief Counsel, Bureau of Internal Revenue.

Witnesses were sworn and testimony given at the said hearing and the Court being fully advised in the facts and the law makes its

FINDINGS OF FACT

I.

That the Con-Rod Exchange, Inc., the corporation on behalf of which this suit was brought, at all times hereinafter mentioned prior to January 8, 1940, was a corporation organized, existing and doing business under and by virtue of the laws of the State of Washington. That it was legally dissolved under the laws of the State of Washington on January 8, 1940; that the plaintiffs, Richard S. Steward and Helen Roberts, were the last directors and the liquidating trustees of the said corporation, and this

cause of action [28] thereby vested in them. That the corporation's principal place of business and plaintiffs' residence is within the judicial district of the above-entitled Court. That each trustee and the said corporation is and was a citizen of the United States and that each has at all times sworn true allegiance to the Government of the United States, and that each has not in any way voluntarily aided, abetted nor given encouragement to rebellion against said United States. That no assignment or transfer of the claim herein or any part thereof or any interest therein has been made.

II.

That the defendant at all times hereinafter mentioned was the acting Collector of Internal Revenue of the United States for the collection district of Washington, having an office and residing at Tacoma, Pierce County, within the above-entitled district, and that the said defendant now is a citizen of the State of Washington, Pierce County, therein.

III.

That on or about April 27, 1936, the defendant, acting under the instruction of the Commissioner of Internal Revenue, determined that the Con-Rod Exchange, Inc. was liable for an assessment of manufacturer's excise taxes in the principal sum of \$2,019.64 and for interest in the sum of \$188.28 under the provisions of Section 606 (c) of the Revenue Act of 1932, said assessment being for excise

taxes for the period from June 21, 1932, to September 30, 1935, upon the manufacture and sale by the corporation of certain automobile parts, to-wit, connecting rods. The defendant further determined that for the period from October 1, 1936 to September 30, 1938, this corporation was liable for an assessment under the above provision of the Revenue Act of 1932 in the sum of \$78.96. Thereafter, acting under the [29] authority of the Commissioner of Internal Revenue, the defendant required the corporation to, and thereupon it did, at the times hereinafter mentioned, pay to the defendant the amounts of \$2,207.92 and \$78.96. On or about February 17, 1940 and April 11, 1940, the corporation duly filed with the defendant for transmission to the Commissioner of Internal Revenue, claims for refund and repayment of said amounts.

IV.

That the taxes hereinabove referred to were paid at the times and in the amounts as follows:

Date of Payments	Amount
September 27, 1937.....	\$50.00
October 27, 1937.....	50.00
November 29, 1937.....	50.00
December 28, 1937.....	50.00
January 26, 1938.....	50.00
February 28, 1938.....	50.00
March 28, 1938.....	50.00
May 6, 1938.....	50.00
May 26, 1938.....	50.00
June 25, 1938.....	50.00
July 26, 1938.....	50.00

Date of Payments	Amount
August 27, 1938.....	50.00
September 28, 1938.....	50.00
October 26, 1938.....	50.00
November 28, 1938.....	50.00
December 30, 1938.....	50.00
January 26, 1939.....	50.00
February 28, 1939.....	50.00
April 6, 1939.....	50.00
April 26, 1939.....	50.00
May 26, 1939.....	50.00
June 27, 1939.....	50.00
July 31, 1939.....	50.00
March 22, 1940.....	636.85
March 22, 1940.....	421.07

Total	<u>\$2,207.92</u>
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November 16, 1936.....	4.66
December 15, 1936.....	3.77
January 15, 1937.....	3.15
February 19, 1937.....	2.11
March 26, 1937.....	2.49
April 28, 1937.....	3.23
May 28, 1937.....	2.78
June 30, 1937.....	4.74
July 28, 1937.....	5.36
August 28, 1937.....	5.15
September 30, 1937.....	6.14
October 29, 1937.....	5.77

[30]

November 24, 1937.....	4.51
December 29, 1937.....	3.24
January 29, 1938.....	2.25
February 28, 1938.....	2.39
March 25, 1938.....	1.15
April 30, 1938.....	1.61
May 25, 1938.....	3.36
June 20, 1938.....	3.52
July 22, 1938.....	1.71

Date of Payments	Amount
August 24, 1938.....	2.00
September 29, 1938.....	1.54
October 29, 1938.....	2.34
	<hr/>
	\$ 78.97
	<hr/>

V.

These claims for refund were made and duly filed upon the official form prescribed therefor by the Treasury Department of the United States and were so filed within four years after the date of payment of said taxes, and said claims set forth the reasons for and the grounds supporting the refunds of said tax payments. Thereafter, under dates of April 18, 1940, and July 31, 1940, the Commissioner of Internal Revenue, in writing, notified the plaintiffs that these claims were disallowed and rejected.

VI.

On the 9th day of August, 1939, the trial of an action by Con-Rod Exchange Inc., the corporation involved herein, against this defendant, was held in the above-entitled court before the Honorable Judge Leon R. Yankwich, Cause No. 8570, in which a refund of manufacturer's excise taxes assessed and collected under Section 606 (c) of the Revenue Act of 1932 was sought. These taxes had been paid by the corporation for the period from October 1, 1935 to August 31, 1936. The said Court, upon the 30th day of August, 1939, made full and detailed findings of fact and conclusions of law, and thereupon entered judgment in favor of the plaintiff corporation.

VII.

The type of material used in the operations of this corporation, the physical process of rebabbitting the con- [31] necting rods, and the basis upon which the business was conducted, were identical in their nature during the periods involved in this action and in the preceding suit, except that it was stipulated that all of the taxes herein involved were levied upon transactions in which customers of the corporation exchanged old connecting rods on which the babbitts had been worn, for newly rebabbitted ones or "exchange sales" similar to those which constituted the largest part of the corporation's business during the period involved in the prior suit. All other material facts involved in the present action were also involved in the preceding action heard by this Court, excepting only the amount of the assessment of and the time of the payment of the taxes, the refund of which is herein sought; the period of time for which they were assessed by the defendant; and the time of the filing by the corporation of the claim for said refund in accordance with the Internal Revenue Code and the Regulations of the Commissioner of Internal Revenue.

VIII.

The Court in the cause above referred to found that the largest part of the assessment of said excise taxes was made with respect to sales by this corporation of rebabbitted connecting rods; that the rebabbitting process performed by the plaintiff

therein upon the connecting rods, and in respect to which the excise taxes therein involved were imposed, whether on an "exchange basis" or on a basis wherein customers received back their own repaired rods, constituted the repair, rehabilitation or reconditioning of used and second-hand connecting rods; that the sale of rebabbitted connecting rods did not constitute sales of automobile parts or accessories by a manufacturer, producer or importer in any instance; that the plaintiff corporation did not include the said excise taxes in the price of the articles with [32] respect to which said taxes were imposed and it did not collect the amount of said taxes or any part thereof from the vendee or vendees of the articles in respect to which said taxes were imposed.

IX.

The Court in the aforementioned cause concluded that the plaintiff corporation was not, during the times involved in that suit, the manufacturer, producer or importer of automobile connecting rods or of any automobile parts or accessories whatsoever within the meaning of Section 606 of the Revenue Act of 1932; that the excise tax imposed by Section 606 (c) of the Revenue Act of 1932 did not apply to sales of rebabbitted automobile connecting rods by one who acquired such rods second-hand and rebabbitted the same and who neither manufacturer, produced nor imported any other automobile parts or accessories. The Court thereupon entered judgment for the plaintiff in the principal

amount of the taxes assessed for the period therein concerned. Said judgment now is and stands unreversed and unmodified and in full force and effect.

X.

The corporation, upon behalf of which this action is brought, did not include the aforesaid excise taxes in the price of the articles with respect to which said taxes were imposed; and it did not collect the amount of said taxes or any part thereof from the vendee or vendees of the articles in respect to which said taxes were imposed. The burden of said taxes was borne solely and exclusively by the plaintiff and the burden of none of said taxes was passed on by the said corporation to its customers or vendees.

Dated this 4 day of March, 1942.

LEWIS B. SCHWELLENBACH
United States District Judge

Presented by:

R. B. HOOPER

Of Attorneys for Plaintiff. [33]

From the foregoing Findings of Fact, the Court makes and enters the following

CONCLUSIONS OF LAW

I.

The individual plaintiffs herein and the corporation on behalf of which they have brought this action and each of them have complied with all statutory conditions constituting conditions precedent to the institution and maintenance of this suit.

II.

That the decision of this Court in the case of Con-Rod Exchange, Inc. v. Henriksen, Cause No. 8570, 28 Fed. Supp. 924, decided August 17, 1939, is res judicata in this cause with respect to the issue of whether or not the taxes imposed herein by Section 606 (c) of the Revenue Act of 1932 and for which this suit for refund was brought, were properly assessed and collected.

III.

That by reason of the unmodified and final decision of this Court in the Cause hereinabove referred to, the Con-Rod Exchange Inc. was not during the time involved in this suit, the manufacturer, producer or importer of automobile connecting rods within the meaning of Section 606 of the Revenue Act of 1932.

IV.

In holding and determining that the tax imposed by Section 606 (c) of the Revenue Act of 1932 applied to the sales of rebabbitted connecting rods sold by the plaintiff during the period from June 21, 1932 to September 30, 1935, and from October 1, 1936 to September 30, 1938, the Commissioner of Internal Revenue has exceeded the authority granted him under the Internal Revenue Act of 1932. [34]

V.

Under the evidence and the law, the plaintiffs are entitled to judgment against the defendant in the

sum of \$2,286.89, together with interest thereon from the respective dates of payment as set forth in the Findings of Fact herein, at the rate of six per cent (6%) per annum and together with plaintiffs' costs and disbursements as provided by law.

Dated this 4th day of March, 1942.

LEWIS B. SCHWELLENBACH

United States District Judge.

Presented by:

R. B. HOOPER

Of Attorneys for Plaintiffs.

[Endorsed]: Filed Mar. 4, 1942. [35]

In the District Court of the United States for the
Western District of Washington,
Southern Division
No. 174—Tacoma

RICHARD E. SEWARD and HELEN ROBERTS, liquidating trustees of CON-ROD EXCHANGE, INC., a corporation,

Plaintiffs,

v.

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Defendant.

JUDGMENT

The above-entitled cause came on regularly for trial on the 13th day of January, 1942, before the

above-entitled Court, Honorable Lewis D. Schwellenbach presiding therein, sitting without a jury.

Plaintiffs appeared by their attorneys, Jones & Bronson, and were represented in Court by Mr. H. B. Jones and Mr. R. B. Hooper, and the defendant appeared by his attorney, Mr. J. Charles Dennis and Frank Hale, United States Attorneys, and was represented in Court by Mr. Thomas R. Winter, Special Assistant to the Chief Counsel, Bureau of Internal Revenue.

Witnesses were sworn and testimony given at the said hearing and the Court being fully advised in the facts and the law, and having made and entered its Findings of Fact and Conclusions of Law herein,

Now, Therefore, it is Ordered, Adjudged and Decreed that plaintiffs have and recover judgment against the defendant in the sum of \$2,286.89, together with interest thereon as provided by law and for costs and disbursements to be taxed as provided by law.

Dated this 4th day of March, 1942.

L. B. SCHWELLENBACH

United States District Judge

Presented by:

R. B. HOOPER

Of Attorneys for Plaintiffs [36]

I, Lewis B. Schwellenbach, District Judge of the United States, and sitting in the District Court of the United States for the Western District of Wash-

ington, on this 21st day of February, 1942, do hereby certify:

That the acts done by the defendant in the above entitled case, as the Collector of Internal Revenue, in imposing and assessing and exacting and collecting the said excise tax, in the amount of \$2,286.89, as set forth in the foregoing judgment, were done in his official capacity as such Collector of Internal Revenue, and the said Thor W. Henricksen had probable cause for his acts, notwithstanding the fact that all of said tax was erroneously collected, and judgment has been rendered for a refund thereof in this case.

Dated this 4th day of March, 1942.

LEWIS B. SCHWELLENBACH

United States District Judge

Judgment corrected and amended pursuant to Stip. and Order filed May 8, 1942.

E. REDMAYNE,

Dep. Clerk

[Endorsed]: Filed Mar. 4, 1942. [37]

[Title of District Court and Cause.]

STIPULATION AND ORDER
CORRECTING JUDGMENT

It is hereby stipulated and agreed by and between the plaintiffs, by their attorneys, Jones &

Bronson, and defendant, by his attorneys, J. Charles Dennis, United States Attorney for the District of Washington and Thomas R. Winter, Special Assistant to the Chief Counsel for the Bureau of Internal Revenue, that judgment in the above case dated the 4th day of March, 1942, be corrected by striking from said judgment in the last paragraph thereof, after the word "thereon" the following words:

"from the respective dates of payment as shown by the Findings of Fact herein in the amount of \$380.14, making a total judgment of \$2,667.03, together with plaintiffs' costs and disbursements to be taxed as provided by law, said judgment to bear interest at six per cent (6%) from this date until paid"

and inserting in lieu thereof the words—

"as provided by law and for costs and [38] disbursements to be taxed as provided by law".

Dated this 29th day of April, 1942.

JONES & BRONSON

R. B. HOOPER

Attorneys for Plaintiffs

J. CHAS. DENNIS

THOMAS R. WINTER

Attorneys for Defendant

Upon the above stipulation of the parties by their attorneys and good cause appearing therefor, it is hereby

Ordered that the judgment be so amended.

Dated this 30 day of April, 1942.

L. B. SCHWELLENBACH

Judge.

Presented by:

THOMAS R. WINTER

[Endorsed]: Filed May 8, 1942. [39]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Thor W. Henricksen, Acting Collector of Internal Revenue, defendant above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the final judgment dated the 21st day of February, 1942, and filed in the above-entitled Court on the 4th day of March, 1942, which judgment was corrected by an order dated the 29th day of April, 1942, and filed May 8, 1942.

Dated this 1st day of June, 1942.

J. CHARLES DENNIS

United States Attorney.

THOMAS R. WINTER

Special Assistant to the Chief
Counsel, Bureau of Internal
Revenue.

[Endorsed]: Filed June 1, 1942. [40]

[Title of District Court and Cause.]

ORDER EXTENDING TIME

It is hereby stipulated by and between the defendant appellant, by his attorneys, J. Charles Dennis, United States Attorney for the District of Washington, and Thomas R. Winter, Special Assistant to the Chief Counsel for the Bureau of Internal Revenue, and plaintiffs appellees, by their attorneys, Jones & Bronson, that the time for filing the record on appeal and the docketing of the action shall be extended to a date ninety days from the date of first notice of appeal, which date was June 1, 1942, and that an order may be entered granting such extension.

J. CHARLES DENNIS

United States Attorney.

THOMAS R. WINTER

Special Assistant to the Chief
Counsel, Bureau of Internal
Revenue.

Attorneys for Defendant
Appellant

JONES & BRONSON

Attorneys for Plaintiffs
Appellees

Approved and So Ordered This 6th day of July,
1942.

LLOYD L. BLACK

United States District Judge

[Endorsed]: Filed July 7, 1942. [41]

[Title of District Court and Cause.]

STATEMENT OF POINTS

The appellant, Thor W. Henricksen, will rely upon the following points in the prosecution of his appeal from the judgment of the United States District Court for the Western District of Washington, Southern Division:

I.

That the United States District Court erred in entering Judgment for the appellees and against appellant for \$2,667.03 and interest; conversely, the Court erred in failing and refusing to enter Judgment for appellant dismissing appellees' suit with costs.

II.

The United States District Court's findings do not support the Judgment or the Court's conclusions of law.

III.

The United States District Court erred in making and entering Findings VI, VII, VIII, IX and X because the contents thereof were incompetent, immaterial and irrelevant in determining the issue of whether or not the appellees are entitled to the refund claimed by it. [42]

IV.

The United States District Court erred in holding (Conclusion of Law II) that its previous decision

of August 17, 1939, was res judicata with respect to the issue of whether or not the taxes involved in this suit were properly assessed and collected.

V.

The United States District Court erred in holding (Conclusion of Law III) that by reason of the previous decision for a different taxable period appellee "was not the manufacturer, producer or importer of automobile connecting rods" during the period involved in this suit.

VI.

The United States District Court erred in holding (Conclusion of Law IV) that the Commissioner exceeded the authority granted him under the Revenue Act of 1932 in determining that the taxes in question applied to the connecting rods sold by appellees during the period in dispute in the present suit.

VII.

The United States District Court erred in holding (Conclusion of Law V) that under the law and the evidence appellees are entitled to judgment against appellant.

VIII.

The United States District Court erred in determining that the sales of the connecting rods by appellees during the taxable period involved herein were not sales of automobile parts by a manufac-

turer or producer thereof within the purview of Section 606 (c) of the Revenue Act of [43] 1932.

J. CHARLES DENNIS

United States Attorney

HARRY SAGER

Assistant United States

Attorney

THOMAS R. WINTER

Special Assistant to the Chief

Counsel for the Bureau of

Internal Revenue.

Copy Rec'd. Aug. 19, 1942.

JONES & BRONSON

Attorneys for Plaintiffs

[Endorsed]: Filed Aug. 20, 1942. [44]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF
RECORD ON APPEAL

To the Clerk of the Above-Entitled Court:

Defendant, Thor W. Henricksen, Acting Collector of Internal Revenue for the District of Washington, hereby designates the entire record in this case to be contained in the record on appeal, more particularly described as follows:

1. Complaint.
2. Answer.
3. Findings of Fact and Conclusions of Law.

4. Judgment.
5. Stipulation and Order Correcting Judgment.
6. Notice of Appeal.
7. Order Extending Time to File and Docket
Record on Appeal.
8. Transcript of Testimony.
9. All Exhibits.
10. Statement of Points.
11. This Designation.

J. CHARLES DENNIS

United States Attorney

HARRY SAGER

Assistant United States
Attorney

THOMAS R. WINTER

Special Ass't to Chief Coun-
sel, Bur. of Int. Revenue

Received copy this 19th day of Aug., 1942.

JONES & BRONSON

Attorneys for Plaintiffs.

[Endorsed]: Filed Aug. 20, 1942. [45]

In the United States District Court, for the
Western District of Washington, Southern
Division

Record of Proceedings:

At a regular session of the United States Dis-
trict Court for the Western District of Washing-

ton, held at Tacoma, in the Southern Division thereof, on the 25th day of August, 1942, the Honorable Charles H. Leavy, U. S. District Judge, presiding, among other proceedings had were the following, truly taken and correctly copied from the Journal Record of said Court, to-wit:

No. 174

[Title of Cause.]

MINUTE ORDER

On this 25th day of August, 1942, on motion of Thomas R. Winter, attorney for defendant, for an order to transmit to the Circuit Court of Appeals, with the Transcript of the Record on Appeal herein, the original exhibits offered or admitted in evidence in the trial of this cause,

It Is Ordered that the Clerk of this Court be and he is hereby directed to transmit to the Circuit Court of Appeals for the Ninth Circuit, with the Transcript of the Record on Appeal herein, the original exhibits in this Cause, to-wit: Plaintiffs' Exhibits Nos. 1 and 2. [46]

[Title of District Court and Cause.]

STATEMENT OF FACTS

Be It Remembered, the above-entitled action came on regularly for hearing, on this the 13th day of January 1942, before the Honorable Lewis B.

Schwellenbach, Judge, sitting in Tacoma, Washington;

The plaintiffs herein were represented by their Counsel, Jones & Bronson, Attorneys-at-Law, of Seattle, Washington;

The defendant was represented by his attorneys, Harry Sager, Esq., Assistant United States Attorney, Tacoma, Washington; and Thomas R. Winter, Esq., Special Attorney, Department of Internal Revenue, of Seattle, Washington.

Whereupon, the following proceedings were had:
[49]

Mr. Jones: Your Honor, perhaps we might take up the Con-Rod case and see what course it is going to take.

The Court: All right.

Mr. Jones: I call it the "Con-Rod Case." The file gives the title. It presents the question of the liability for manufacturer's excise tax under the Act of 1932.

Now, as the case develops, it will be shown that this relates to the manufacture or repair of Con-rods.

The Court: I have read the briefs.

Mr. Jones: Well, there are three periods involved here. The first period which is concerned in this suit, is from the time the account became effective in July of 1932, to the first of October, of 1935. Then there was a period of one year, from October 1935, to October, 1936, that was separately assessed and collected and then there was the pe-

riod from October of 1936 to October of 1938, which was where the payments were made pursuant to the audit that had been made, and requirement, and that is a separate period.

Mr. Winter: Mr. Jones, with respect to that latter period, that was based entirely on the returns filed by the taxpayers— no issue as to the percentage, that is all strictly exchange business, Your Honor.

Mr. Jones: That is right, Your Honor.

The Court: What do you mean by that, “strictly exchange”?

Mr. Winter: That is strictly where a customer [50] would exchange old rods and get an entirely different set; he wouldn't get his own rods back. In other words, they would call it “Con-Rod Exchange”, which the name implies. * * If someone took four rods to the garage, they would take the old rods back and rebabbitt them and put them back in stock.

Mr. Jones (Continuing): These three periods were subject to separate assessment and it just happened that this second period for the one year was paid all at once; the Collector gave some time on the payments of some others and so, it seemed most expedient to bring the suit on that.

As a matter of fact, it was contemplated, at that time, that a suit would determine the whole period, not a matter of binding the defendant but only a historical explanation. So, we brought that suit and tried it before Judge Yankwich.

Now, the processes that were involved, as Counsel says, were rebabbiting of connecting rods. Those processes fell, generally, into two categories, I might say. A customer having some wornout connecting rods, would go in the plaintiff's shop and say, "I want to have these rods repaired" and he would hand him over the particular rods, he would rebabbit those rods and turn them back to the customer.

That is strictly a repair job under any of the decisions and under the rulings and enforcement of the Collector's office, and isn't considered manufacture.

I think there is no controversy on that point, but, in addition to repairing— [51]

Mr. Winter (Interrupting): In that connection, we will concede there is no controversy on that point and the assessment doesn't contemplate any tax on those transactions, where a man would insist on having his own rods repaired and returned to him.

The Court: That is the first period?

Mr. Winter: Yes, your Honor. We contend that the Deputies, from the records of the taxpayers, to the best of their ability, and legally, accepted their records and assessed the tax or recommended assessment of the tax entirely upon that basis and none other.

There is a further period in there that the record will show that there were no records for a very early period, for 1932 and 1933, and the assessment was based upon a percentage basis; that is, accept-

ing the same basis as 1934 and 1935, using the same basis, because there was no other basis to go on, and we, as a Commissioner, didn't err in taking that position.

Mr. Jones (Continuing): As I say, these operations fall into two classifications: where you take rods in to have them repaired, like shoes they make the repair and return those specific rods or exchanges back * * *. (Completes opening Statement for the plaintiff herein.)

The doctrine of *res judicata* is well established and, under the authorities, I think is plainly applicable to this case.

That is our prime position here. Should Your Honor feel the doctrine of *res judicata* is not applicable, then it becomes necessary to determine how [52] much of this assessment is based on purely exchange transactions and how much on repair transactions. We are in this position, that the Agents came to us and made this audit, I think they were there for some five or six months; it involved going over, I suppose, thousands of transactions, very small in themselves, \$2.00 or \$3.00 or \$4.00 and figuring the tax on that. We got no bill of particulars with our tax; we simply got a demand for payment of so much manufacturer's tax, so we don't know except as we infer or surmise, what items the defendant took into account in assessing and collecting this tax.

I have suggested to Counsel for the Government—I asked whether we could get a statement from them

of what the tax covered and he said no that that was the levy and they didn't propose to furnish any statements.

It is true, I never asked for a bill of particulars on it but I made this suggestion then, that if the Court would dispose of the issue of law—if you hold that this is *res judicata*, we don't need to go into these thousands of transactions. The manufacturer is here; he says he has about a ton of records down in his car to bring up here, if we have to do it. * * * If we went through all these items, it would take a tremendous length of time and I don't think we ought to have to do that. If Your Honor decides the *res judicata* is applicable** we don't have to. If not, and it is necessary for the parties to make this segregation, I feel sure if the Government will have their man, their investigating agent sit down with our auditor, they can determine those matters and I don't think we need [53] to take the time of the Court to pass on those small items.

That, I think, presents the matter, as we see it, for submission.

Mr. Winter: (Makes opening statement for the defendant herein.)

The Court: Are you agreed you have three periods: the first period, you have no records, you assume you have the same percentage in the first period as you have in the case before Judge Yankwich, is that correct?

Mr. Winter: No, there are two periods involved, from 1932 to 1935 and from 1936, October 1936 to 1938.

The Court: He tried October 1935 to 1936?

Mr. Winter: Yes.

The Court: The first period prior to that time, as I understand, you don't have the records?

Mr. Winter: Yes, we have records for 1932 and 1933; we don't have records for 1932 and 1933, but we examined the records for 1934 and 1935 and took the actual exchanges from their records and arrived at that tax, month by month, and assumed 1932 and 1933 were the same amounts with respect to tax as there was in 1934 and 1935, according to their volume of business.

The Court: Then 1936 to 1938——?

Mr. Winter (Interrupting): 1936 to 1938, that is all exchanges, because they were on returns and actual records kept by the taxpayer and filed by the taxpayer and they paid the tax with the return.

The Court: You agree, as far as 1936 and 1938 are concerned, they are all exchanges? [54]

Mr. Jones: Yes, we agree all were exchanges for that period, that is right.

Mr. Winter: (Continues opening statement.)

The Court: What is the disagreement? Last two years for the first period?

Mr. Jones: Of the last two years of the first period? Of course, I can't state——

Mr. Winter (Interrupting): The plaintiff hasn't alleged what amount.

Mr. Jones: We can't because we don't know the basis of the assessment, but the disagreement would be (1) that it is *res judicata* under the other de-

cision and then from the practical standpoint, we don't know what the disagreement is because we don't know the details of what enters into the assessment. That is what we have to go into through investigation of the records, when we find out the basis of the assessment.

Mr. Winter: Here is the Deputy Collector's report. (Handing document to Mr. Jones.)

Mr. Jones: I can't very well go into details now; I tried to get this information quite awhile ago and I couldn't get it.

The Court: The point I have in mind? suppose I should decide that plaintiff's theory about *res judicata* is correct, you still have to make a record here as to the amount there is in dispute, about the last two years, they all are exchanges?

Mr. Jones: Yes, I thought about that feature of it. Suppose Your Honor decided *res judicata* was applicable and we still don't have the record to find [55] anything to the contrary, if the Appellate Court should disagree——

Mr. Winter (Interrupting): They would have to send it back for a new trial.

Mr. Jones: I think that could be reserved—if you decide *res judicata* is applicable, we can submit it on the understanding Your Honor is not deciding what the result would be, if it is not applicable, that if the case is reversed, that would be a matter to be taken up and agreed upon?

The Court: Is that satisfactory, Mr. Winter?

Mr. Winter: I see no necessity, unless Counsel would stipulate that, unless Counsel wants to go

into the—of course, that is the Court's prerogative; I don't know whether it will be satisfactory to the Department. I can't speak for the Department, but all the Circuit Court would do if it should reverse your Honor would be to just send it back for new trial and then the evidence could be taken at that time.

The Court: Yes, but I don't want any opinion of the Circuit Court saying I should have done it in the first place, and you are the only representative of the Department here and you are in Court.

Mr. Winter: Well, of course, we maintain, if the Court please, that all of those are exchanges and we have the records, we have taken from the records to prove it and the burden is upon the taxpayer to prove otherwise.

Mr. Jones: I concede Counsel is correct, the burden is upon us, if we are going to go into these facts, the burden is upon us to go into them, but I was [56] hoping—

Mr. Winter (Interrupting): There is no allegation in the complaint what part of—you haven't alleged, they were not exchanges.

The Court: What I am trying to do is to work out a situation where we can avoid taking a lot of testimony. If I am going to decide the case on res judicata, there is no sense of sitting up here a couple of days listening to testimony as to whether certain connecting rods were exchanges or repairs; yet, I don't want to just decide it upon—what I want to do, if Counsel is willing to have an agreement—that

for the purpose of this hearing, I can assume they are all exchanges and decide it upon that basis and then if I decide for the Government upon the question of *res judicata*, then I will have to hear the testimony as to which were exchanges and which repairs.

Mr. Winter: Of course, we are not contending any of the sales, which are set up, are sales.

The Court: I am asking if it is satisfactory to you, that I can go ahead now and decide it upon the question of *res judicata* and assume they are all exchanges? That is what I asked you?

Mr. Winter: May I confer with Mr. Dennis on that matter, Your Honor?

The Court: Yes.

Mr. Winter: As a matter of fact, I am merely assistant to the United States Attorney on these cases.

(Short recess.)

Mr. Winter: I have conferred with Mr. Dennis [57] and both he and I, since the United States is the defendant in this case, asking for a money judgment, in the event Your Honor decides the question is *res judicata*, adverse to the United States, the amount involved would justify an appeal; whereas, if Your Honor found that, as a matter of fact, the taxpayer, in any event, didn't owe more than a few dollars, it would then raise the question as to whether or not an appeal would be justified because of the amount involved.

I think that is about the only point. If we were

not the defendant in this case, of course, I think it is to the plaintiff's advantage and to the disadvantage of the defendant in this case—so, we would prefer that the plaintiff prove his case on all issues. If Your Honor decides that way, adverse to the United States, on the issue of *res judicata*—of course, we take the position that this decision, that the effect of the decision, as conceded by Counsel, was to overrule the proposition of law, as to whether or not this process is a manufacture or not—we say it is analogous to those cases.

(Further argument.)

The Court: You have the same process each year, do you?

Mr. Winter: We have the same process but different percentage—whether or not that was in the mind of the Court, I have no way of knowing, except it does not appear to have been——

The Court (Interrupting): If that had been in the mind of Judge Yankwich, he would have held 25 percent was collectible. [58]

Mr. Winter: No, he had already held in the *Armature* case that that process—there were armatures involved in the first case, Your Honor; in the case of the *Con-Rod Exchange* case, there were armatures involved in that case.

Mr. Jones: Very insignificantly.

Mr. Winter: Very few instances, but there were a few armatures involved in that case; there are no armatures involved in this case.

Mr. Jones: No armatures involved here.

The Court: Rewinding of armatures is much more a manufacturing process than rebabbiting connecting rods.

Did you ever rewind an armature?

Mr. Winter: Yes, Your Honor, I worked in an armature rewinding company, I know the process, but I have never had occasion to work on a rebabbiting job but there are a number of parts about an automobile, probably 50 percent of the automobile parts, which are interchangeable, which are renewed. * * *

The Court: I think under this other case, this Clawson & Bals case, that, clearly, I have got to hold that the rebabbiting of connecting rods is a manufacturing process. Frankly, when I read the reararmature case, I thought there was a lot of difference between that and rebabbiting connecting rods, but when I read the second case——

Mr. Jones (Interrupting):

There are two decisions just rendered by the Circuit Court of Appeals, 9th Circuit which apply—Armature exchange case, rebabbiting connecting rods—where they are exchanges. [59]

Mr. Winter: (Further argument.)

The Court: Let's forget about the problems and get in and argue this question of res judicata, first.

Mr. Winter: That is what I am saying.

(Further argument.)

Now, we don't concede that the facts are the same, we concede that the process is the same, but we concede that the facts are different in the percentages and amount of business which they did, that they

were more like Clawson & Bals in the first period, in that practically all of their business was exchange business; that is, they came closer in that period to a manufacturing than they did in the later period, because they started out with a large stock in the early period and were practically exclusively in the exchange business except those few types, extra types which would come in to be rebabbited. So, we think that the facts are different, the plaintiff is different.

The Court: Aren't those facts against you, though?

Mr. Winter: The Courts have held, you don't apply the rule of *res judicata* where the United States and the Collector——

Mr. Jones (Interrupting): What is that, Mr. Winter? Don't apply it where the distinction is between the United States and the Collector——?

Mr. Winter (Interrupting): Yes.

Mr. Jones: We have no difference in the plaintiffs here—to apply the rule of *res judicata* here, where the decision has been overruled by this Court and the decision in the armature case binding upon this Court, [60] because the Ninth Circuit case—not the Con-Rod Exchange case, no, Your Honor, but the principle, the process as to whether or not it was taxable or not taxable, was overruled by the Circuit Court of Appeals, Ninth Circuit.

The Court: I don't think any estoppel lies, after the armature case was decided in any case, because the element of estoppel runs through the basis of the *res judicata* rule.

Mr. Winter: Of course, that is our position, to apply the rule of *res judicata* here, particularly by the same parties and same subject—if they manufactured today (the fact is, they are out of business), nevertheless they could still revive the corporation and be the same corporation.

The Court: Do you have any other cases, aside from this armature case? I have a feeling the Blair case is a case where the decision in the State Court was a decision, so far as the federal Court is concerned, a question of fact, they considered the State rule as a question of fact and decided the Federal Court case and that it made a different state of facts—that that is the distinction between the Mallard and this case.

Mr. Winter: We say the rule in the Armature case made a different state of facts.

The Court: That is a rule of law?

Mr. Winter: Well, it held that the process was a manufacturing process as distinguished from a repair matter. Of course, that is our only position, we concede that without the armature case, it certainly would be *res judicata* in this case but since the decision upon which the Court relies in arriving at his decision was erroneous— [61]

Mr. Jones (Interrupting): Counsel makes that concession, I think he concedes the argument because that is the doctrine of *stare decisis*, the application of the rule to other similar cases, but *res judicata* is not concerned with that; we are concerned with the decision, admittedly, erroneous. I

admit the decision was erroneous but it stands as a final adjudication between these parties, under res judicata, no matter how erroneous the decision is, it is the law of the parties.

(Further argument.)

The Court: Any change in fact to which you refer is against the Government.

Mr. Winter: No, any change in the facts, in the later years is against the Government; all the facts are more favorable to the Government in the earlier years because there they were clearly a Clawson & Bals business.

The Court: It seems to me I have to construe Judge Yankwich's decision on the basis that he felt that whether or not they were exchanges, or whether they were manufacturers—using the term “manufacturer” in the light of the armature decision, not in the light that he considered it——

Mr. Winter: Your Honor is also going to find the facts the same in evidence here, but we don't admit the facts are the same.

Mr. Jones: Well, I will put the evidence on.

The Court: I will make a ruling in favor of the plaintiff on the question of res judicata; I think that this Blair case doesn't answer the Tate case, because the State decision was considered in the Blair case, not as a [62] decision in the Federal Court on the question of law, but as a question of fact to be considered by the Federal Court; the State Court having laid down a rule, that was a fact considered by the Federal Court and it made a dif-

ferent set of facts. In fact, the Blair case was the first case deduced and I don't feel, since that is the case, upon which you rely, that the Government has answered the case of *Tate v. Western Maryland Railway Company*.

I will rule for the plaintiff on the question of *res judicata*.

As Mr. Jones suggested, you people can get together and have your respective accountants agree upon the facts about this case and save a couple of days' time for the Court and lawyers and everybody else. If you want to try that, why, I will continue the case over until the next time I come back.

Mr. Winter: I don't know how we can go any further than we have gone.

Mr. Jones: I think I can make a suggestion on this.

Mr. Winter (Indicating): As a matter of fact, Your Honor, Your Honor can see the sheets I have before me, are the actual invoice number of all the items which were taken from the actual records—of course, our copies. Now, the plaintiff has the burden—the burden is upon the plaintiff to show just what were exchanges and what the amount of their exchanges were.

The Court: You have your man here who did this work?

Mr. Winter: Your Honor, he is working—not [63] in the Government service. I have no control over him. I will just have to get someone in the Government service to work on it.

The Court: He is here today?

Mr. Winter: Yes.

Mr. Jones: We have our accountant here.

The Court: Why not go ahead with the other case during the rest of the morning and let the two of them go in there and see if they can figure the thing out.

Mr. Jones: Mr. Winter, I am satisfied if you give us a record of the stuff you have, we can tell how much we dispute and in what category it falls, whether an exchange or new sale.

Mr. Winter: Mr. Trace, head of the Miscellaneous Tax, is here. I will ask him to see what they can work out. Mr. Trace, you understand what the Court has in mind?

Mr. Jones: I think I should make a record by testimony in support of the *res judicata* issue; unless, I didn't catch just what Your Honor said, whether you said upon admissions of Counsels you would hold it applied?

The Court: No, I am not satisfied, with the testimony, as a matter of law——

Mr. Jones (Interrupting): In other words, you hold *res judicata* is applicable if the facts sustain it and I think I should submit at this time the testimony on the *res judicata* issue. Is that agreeable?

The Court: If there is a possibility of the two gentlemen getting together, wouldn't it be better to do that this afternoon, in a couple of hours they will have it worked out—then we can take the testimony? [64]

Mr. Jones: I think the testimony is distinct—I thought if I could submit that testimony, just as to the *res judicata* feature,—I will have to have Mr. Trace to do that.

The Court: All right.

RUSSELL TRACE,

called as a witness on behalf of the plaintiffs herein, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Will you state your name, please?

A. Russell Trace.

Q. What is your business, Mr. Trace?

A. Chief of the Miscellaneous Tax Division, Bureau of Internal Revenue.

The Court: What are your initials?

A. R. Russell.

Q. How long have you held that position, Mr. Trace? A. Nearly 25 years.

Q. Does the matter of collection of manufacturer's excise taxes under the Act of 1932 come under your jurisdiction, insofar as they are in this territory? A. Yes.

Q. And are you familiar with the tax that was assessed against the Con-Rod Exchange, the predecessor of the plaintiffs in this action?

A. Yes.

Q. What do your records show, Mr. Trace, as

(Testimony of Russell Trace.)

to the different [65] assessments that were made against this plaintiff, have you got a record there?

A. In what respect do you mean?

Q. Well, the periods covered and amounts. You have that record there?

A. I haven't the assessment here; all I have are the claims for abatements and rejections.

Q. May I ask you this: Do you recall that there were two assessments, at any rate separate assessments, one for the period, beginning of the account, July 1932 up to the end of September 1935?

A. Yes.

Q. The other October 1st, 1935, to the end of September 1936? A. Yes.

Q. What was the reason for there being two assessments instead of all being one?

A. Well, I am unable to answer that question, definitely.

Q. Well, so far as you know, was there any reason?

A. The reason was, as far as I can remember, was to get the first in before the statute of limitation would run against it but I am not so sure that that is true, I can't answer your question.

Q. So far as you recall, was it due to any difference in the character of the business or application of the tax? A. No, sir.

Q. Is it your understanding that this tax—for the period from July 1, 1932, to the end of September of 1935. involved in this action, was entirely a

(Testimony of Russell Trace.)

tax due on operations concerning connecting rod repairs or manufacture? [66]

A. So far as the records show, it was.

Q. Did you examine any of these invoices and records, yourself? A. No, sir.

Q. Do you know whether there were any records that were examined for the period of 1932 and 1933? Did the plaintiff have any records for that period?

Mr. Winter: We object to that. It doesn't appear this witness examined them. How would he know?

Mr. Jones: I am asking if he knows?

A. No, sir, I have no knowledge. All I have is the deputies' reports. I have no knowledge.

Q. Who were the agents who made your examination?

A. Well, there were different ones.

Mr. Winter: (Handing document to the witness)

A. (Indicating) Here is one here, original reports of these signed by Phillip Evans and L. C. Hazard and Byrd.

Mr. Winter: Who is that?

A. I think it is "Berg".

Mr. Winter: The second name you gave?

A. L. C.—Antegard.

Mr. Winter: I might say, Your Honor, Mr. Antegard was subpoenaed, but as he is deceased, of course, we didn't know where to serve him.

Q. Are any of those agents in your employ now?

(Testimony of Russell Trace.)

A. I think Mr. Evans is.

Mr. Winter: In your employ?

A. Isn't he in now? I am not acquainted with these men in the field. The last I knew, he was. I have only just been in the office here.

Q. Is one of the agents who made the examination in the courtroom now? [67]

A. Well, I don't know.

Q. Mr. Winter, do you have one of the agents here?

Mr. Winter: Yes, Mr. Evans is here.

Mr. Jones: All right, that is all of this witness.
(Witness excused)

PHILLIP EVANS,

called as a witness on behalf of the plaintiffs herein,
being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Will you state your name, please?

A. Phillip Evans.

Q. Mr. Evans, were you connected with the Excise Division of the Collector of Internal Revenue's office for a period? A. Yes.

Q. Did you have anything to do with auditing the accounts of the Con-Rod Exchange for manufacturer's tax purposes? A. Yes.

Q. Just tell us what you had to do and what period you covered?

(Testimony of Phillip Evans.)

A. Well, of course, several years ago, but my recollection is it was covering the period from 1932 on and we were instructed as to how to interpret the application of the tax and we went up there, went through the different invoices and applied them according to what we considered a correct interpretation. [68]

Q. Do you have any records that you made in connection with your investigation?

A. With me, personally?

Mr. Winter: The Report? A. Yes.

Q. What have you in your hand there?

A. Here are the returns we made, which are practically summaries we made, picked out of the invoices.

Q. Have you got the detailed worksheets where you went over the separate invoices? A. Yes.

Q. Where are those?

A. Mr. Winter has them.

Q. Will you produce those, please?

Mr. Winter: (Hands document to the witness.)

Q. Now, what are these documents that Mr. Winter has handed you?

A. These represent the actual figures taken off, month by month, from the invoice books as given to us.

Mr. Winter: You have the invoices here, Mr. Jones?

Mr. Jones: Yes, we have just a small portion here but we have the rest of them available.

(Testimony of Phillip Evans.)

Q. I was wondering, Mr. Evans, if these showed the invoice numbers, so they can be identified and tied up with the invoices. They do, don't they?

A. Yes, invoice numbers and dates.

Q. Now, did you find any records for the period in 1932 and 1933?

A. It is my recollection, there were no records available for that period. [69]

Mr. Winter: Just refer to your report, if you need to, Mr. Evans.

Q. Yes, if you want to look at the report to refresh your recollection, you may do it. If that was the case, what basis did you take as to the assessment of any tax or setting up any assessment for that period for which no records were available?

A. If I remember rightly, that was set up upon agreement, based upon the ensuing years.

Q. That is, you applied the figures that you found in periods subsequent to 1933 back for the period 1932 and 1933, in some way, did you?

A. Let's see if I get that right. We took the figures for 1932 and applied them in proportion as ordinarily would be when it was admitted the business was practically the same, same proportion, same amount of business and it was admitted, it seems to me at that time, it was admitted that would be a fair assessment.

Q. When you say it was the same kind of business and in the same proportion, what do you mean by that? that is was the same in 1932 and 1933 as it was in 1935 and 1936?

A. Yes.

(Testimony of Phillip Evans.)

Q. And did your investigation show that to be a fact?

A. We couldn't prove it, because the records weren't available.

Q. Well, did your investigation show that the business was the same in 1934 and 1935? where you had records, as it was in 1935 and 1936?

A. Well, I would have to go through these and compare them and see how they grew. [70]

Q. I don't mean in amounts but character of the business?

A. The character was about the same.

Q. Did you find anything except the matter of connecting rods involved?

A. Well, sir, that is about five or six years ago, but I do think there were a few other items involved, where they were characterized as "exchanges."

Q. Could you tell me what they are or pick them out?

A. Well, I would have to go through these detailed slips and see but I don't think that this information we have got here——

Q. (Interrupting) Maybe I can shorten this, Mr. Evans, if I can ask Mr. Trace one question from where he is.

Mr. Jones: Mr. Trace, was there anything except connecting rods involved in the assessment for 1932 to 1935?

Mr. Trace: Nothing that I know of.

(Testimony of Phillip Evans.)

Mr. Winter: I don't think there were, Mr. Jones, we will concede there were nothing else.

Mr. Jones: I just wanted to make the record clear on that.

Mr. Winter: No assessment there for armatures.

Q. You don't need to bother any further on that, Mr. Evans, you looked at the invoices or copies of the invoices that the Company kept, of course?

A. Yes.

Q. Did you find, in any case, that they billed any customer with any amount as tax on the sales?

A. I don't remember; on the other hand, it seems to me I do remember they had records with the tax being on, some of those invoices. [71]

Q. But you don't remember?

A. No, I wouldn't want to go on record.

Q. Did you make any report whether they had passed the tax on or not? A. No, I didn't.

Mr. Winter: What was that?

Mr. Jones: I asked him if he made any report whether they had passed the tax on or not.

Q. Did you investigate the physical operations involved in the repair or rebabbiting of connecting rods? A. Well, a casual one.

Q. Did you notice whether there was any difference in the operations between the period from 1932 to 1935 and the period of 1935 and 1936?

Mr. Winter: What do you mean by "operations"?

Q. Mechanical and physical—of rebabbiting operations?

(Testimony of Phillip Evans.)

A. Operation, 1932 and 1934—we had no way of connecting up; we had kind of a visit to the workshop, more as a “visit” than anything else, just to see what they were doing. Now, at this time, I couldn’t tell you exactly what the procedure was.

Mr. Jones: That is all. I would like to have these worksheets marked and offer them as an exhibit or at least to have them at this time marked for identification.

Mr. Winter: Aren’t the records the best evidence? These are merely taking copies from the records.

Mr. Jones: This is the basis on which the Government is setting up this tax. I want to use them as a matter of reference, to determine the correctness of the tax, that is their own record of the tax basis. [71a]

Mr. Winters: That is, record invoice numbers which they add up.

Mr. Jones: I am not offering this to prove the transaction represented by the invoice, I am—in fact, I am not offering it at all now but I would offer it to prove the basis of assessing the tax and our records don’t show that; I would like to have them identified.

The Court: You can get anything identified you want to.

Mr. Winter: Yes.

Mr. Jones: When that question comes up later. That is all, Mr. Evans.

(Testimony of Phillip Evans.)

The Court: Do you want to mark them now?

Mr. Jones: Yes, if the Clerk will mark those for identification, please.

The Clerk: Mark it plaintiffs' or defendant's?

Mr. Jones: Plaintiffs' 1.

The Court: You describe those as "worksheets"?

Mr. Jones: I understand that they are the Agents' worksheets and working records, forming the basis for the assessment of the tax.

The Clerk: Plaintiffs' exhibit No. 1.

Plaintiffs' Exhibit No. 1, the worksheets just referred to, marked for identification.

Cross Examination

By Mr. Winter:

Q. Mr. Evans, will you refer to your original report and just state to the Court when you made the investigation and what period of time it covered?

[72]

A. Your Honor, we went in there in 1935.

Q. About when?

A. In, about August, latter part of 1935.

Q. What is the date of your report? Is this your signature here?

A. November 6th.

Q. You made a report, November 6th?

A. November 6th.

Q. Prior to that time, as I understand you, Mr. Evans, you took the sales-slips of the Con-Rod Exchange and you examined each and every one of those sales-slips, did you?

A. Yes.

Q. For the period 1934 and 1935?

A. Yes.

(Testimony of Phillip Evans.)

Q. There were no records for 1932 and 1933?

A. No, sir.

Q. And upon your findings, from those records, you determined, did you not, the exchanges of the so-called "exchanges" of Con-rods during that period?

A. That is my recollection.

Q. And how did you arrive at the amounts which you set forth, statement of the sale, the exchange, forging and the total?

A. How did we arrive at it?

Q. Yes?

A. We took the figures shown on the sales-slip.

Q. Figures shown on the sales-slip, yes.

A. Then furnished a schedule of forging prices.

Q. Was that a schedule of "Con-Rod Exchange", nationally advertised? [73]

A. It was given to us in mimeographed form, if I remember right.

Q. You also have a mimeographed form?

A. Yes, mimeographed list, that is all typewritten list—we were told those were figures to apply on cost of forging.

Q. And you applied those as the cost of forging in each instance?

A. Yes, on each individual sale.

Q. Were you furnished with a statement or a list of the prices of the piston Service Company, do you recall?

A. No, sir, not at the time we were making settlement of the Con-Rod, we hadn't approached the Piston Service.

(Testimony of Phillip Evans.)

Q. Well, did you have any price list of any other Con-Rod Companies? A. No, sir.

Q. (Indicating) Are these the sheets which you refer to? A. Yes.

Q. Is that the typewritten copy, mimeographed copy, you got?

A. That looks like it; there were some others, you have some more in your hands.

Mr. Winter: (Hands document to the witness.)

Q. Those sales prices were all furnished to you——? A. (Interrupting) By the Company.

Q. By the Company? who furnished them to you?

A. From the office.

Q. Mr. Taylor or Mr. Seward?

A. From Mr. Seward's office, Miss Morgan, I forget her name, it was furnished at the same time we went down to get the books, sales books which were all bound monthly books. [74]

Q. And you used those figures from those sheets to arrive at the sales prices and cost of the forgings?

A. Yes, that is how we put up our worksheets.

Q. Wherever you found, on the records what appeared to be a repair job or where——?

Mr. Jones (Interrupting): Mr. Winter, those papers you showed him, would you keep them separate? I am going to ask him to identify them. We may want to refer to them.

Q. Wherever you found on the records what indicated to you to be a repair job, did you include any of those items in your amounts to arrive at the taxes which you recommended for assessment?

(Testimony of Phillip Evans.)

A. At this time, my recollection is, we put nothing on our worksheets except such items as were marked with "exchanges."

Q. What does the little item "p", does that refer to "piston" Service?

A. Let's see, if I remember rightly again, that "p" was put there, I think that was put there to avoid a repetition of the taxes applying to the Piston Service. Now, that is my recollection of it.

Q. You excluded all sales, did you not, or did you exclude all sales to other jobbers who were not considered to be manufacturers?

A. Yes, where contemplated going there to set up assessments there trying to eliminate duplicate taxation.

Q. Did you make an investigation in later years with Mr. Prine? A. I did.

Q. Was there any difference in the percentage of business [75] which is shown on the records in later years or what was the percentage of the business shown by the records in later years and in former years with respect to so-called exchanges and so-called repair jobs after—? I am referring to after the period in 1935, when the inserts came into use? A. I don't remember.

Q. You don't remember?

A. Except the business might have gone down, but I couldn't tell you what the respective percentages was in comparison, those previous years.

Q. Did you make an investigation for the period

(Testimony of Phillip Evans.)

from 1936 to 1938 or was there any investigation made at that period?

A. There was a later investigation.

Q. Well, you are referring to the investigation for 1935 and 1936? A. Yes.

Q. But after that, you didn't go in there after 1936?

A. I was only there on two occasions, two periods is all. Yes, that must be the second one.

Q. Well, it has been stipulated, I think, been agreed that later period was upon returns filed by the taxpayer?

Mr. Jones: Yes, upon returns filed by the taxpayers, and those are true exchanges, the third period.

The Court: Those returns were filed, 1937——?

Mr. Jones (Interrupting): They were filed in 1936, 1937, 1938, as I recall it.

Mr. Winter: That is all. [76]

Mr. Jones: After this audit was made and then they made the returns and included in those returns items that were strictly exchanges, which we contended were not taxable and which Judge Yankwich found not taxable, but now, under the *Armature Exchange Case* would be considered taxable.

The Court: Do you know when the brief was filed, complaint was filed in the case Judge Yankwich decided?

Mr. Winter: The 13th of January 1937, subscribed to.

(Testimony of Phillip Evans.)

Mr. Jones: 24th of January 1938.

Mr. Winter: I think that is about when it was filed.

Mr. Jones: Issuance of the subpoena or process. The complaint bears the Clerk's endorsement, of filing on January 24th, 1938.

Redirect Examination

By Mr. Jones:

Q. Mr. Evans, I wonder if you recall that these invoices bore on them a notation in pencil, some notation indicating that they were exchanges of connecting rods in cases marked—E—X—Conrod—something like that? A. Yes.

Q. Now, didn't the parties there at the plant representing the plaintiffs tell you that that was just a method they followed for their own records and many of those marked "exchanges" were not true exchanges but were, in fact, repairs, didn't they tell you that at the time you were [77] making your audit?

A. I think in our first conversation, the contention was held all that work was repairs.

Q. Well, now, when you made your audit, did you go into each item with the parties or did you set it down according to what the notation was on the invoice?

A. We set it—we set up our worksheets on the basis of those invoices plus those memorandum sheets, showing the value of the forgings; occasionally, we would call in the company officials and in-

(Testimony of Phillip Evans.)

vite them to scrutinize it so they could follow our procedure and they were satisfied with our procedure.

Q. Now, who was it said he was satisfied with your procedure?

A. That is satisfied with the way in which we were making it out.

Q. Wasn't there, in fact, now, quite a bit of dissatisfaction about your putting down in your assessment sheet items as being exchanges just because they said on the face of the invoice it was "x-Con-rod"?

A. Yes, there was considerable objection.

Q. They said, as a matter of fact, you were putting down items that were really repairs?

A. That is what they considered them, yes, that is true.

Q. And in making up your worksheets, you went according to the invoices and if they showed on their face "x-Con-Rod" you put it down as an "Exchange", is that right? A. That is right.

Mr. Jones: That is all. I would like to [78] have the sheets——

Recross Examination

By Mr. Winter:

Q. The invoices showed repairs, of course you excluded from your——?

A. (Interrupting) Yes.

Q. They contended, as I understand, that all—whether exchanges or repairs—all were non tax-

(Testimony of Phillip Evans.)

able items, that is what their contention was?

A. Non taxable, inasmuch as they were repairs.

Q. Of course; did they make a contention with respect to the exchanges, also? contended they were "repairs"?

A. Yes.

Q. No distinction was made?

A. No distinction was made.

Q. Did you make an investigation as to customers or as to the amount of business which were exchanges and which were repairs?

A. Yes, we did.

Q. What did you find?

A. We found that in cases where we were told they were repairs, we investigated among the customers and found that in all instances, it wasn't the rods that they sent up that came back, the rods came back to them over the counter and they eventually had to make good with old forgings, after dismantling of the car.

Q. And what percentage of the business would you say, from the records, showed which were exchanges and which were——?

A. (Interrupting) In all those cases, they were exchanges and made on the basis of turn-in of old forgings. [79]

Q. There were, however, some so-called "repairs" in the records were there?

A. There were some invoices, I remember, at this time in which they spoke of "repairs" but whether repairs spoken of, we didn't include them in the worksheet.

(Testimony of Phillip Evans.)

Mr. Winter: That is all.

ReRedirect Examination

By Mr. Jones:

If it showed on the invoice “repairs”, you didn’t include them in your worksheets?

A. That is right.

Q. If it showed on the invoice “x-Conrod” you remember that? A. Yes.

Q. If it showed that, you considered that, definitely, an “exchange” without investigating the facts?

A. Yes.

Mr. Jones: That is all.

Rerredirect Examination

By Mr. Winter:

Q. I thought you said you investigated some of those cases to find out whether they were?

Mr. Jones: He said a few.

Q. You investigated a few of those cases to find out the facts? A. Yes.

Mr. Jones: Will you let us have a few of those sheets, Mr. Winter? I am looking for those price-lists on the exchanges you identified. [80]

A. Forgings, Mr. Winter has them.

Mr. Winter: I put them on that exhibit there. (Indicating Exhibit No. 1) Here they are. (Indicating)

Mr. Jones: Then let them go in the identification, as a part of that exhibit.

That is all of my evidence.

(Witness excused)

RICHARD S. SEWARD,

called as a witness on behalf of the plaintiffs herein,
being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. State your name?

A. Richard S. Seward.

Q. You are one of the plaintiffs in this case, Mr. Seward, as a liquidating trustee of Con-Rod Exchange? A. Yes.

Q. And what was your connection with the Con-Rod Exchange?

A. I owned a portion of the stock in it.

Q. And you were an officer in it? A. Yes.

Q. What office did you hold?

A. I believe I was Vice President, one time; later, I was President.

Q. Now, are you familiar with the physical and mechanical operations that were used in the repair or rebabbiting of connecting rods?

A. Quite so. [81]

Mr. Winter: We will concede that the facts with respect to the actual manufactory, or repair, whichever you wish to call it, as set forth in Judge Yankwich's opinion, pertain to this period; I mean, the actual manufacture.

Mr. Jones: All right.

Mr. Winter: I am limiting to that, so I think the Court is familiar with the facts set forth—

Mr. Jones (Interrupting): I want to ask the witness one further question, then.

(Testimony of Richard S. Seward.)

Q. State whether or not, in charging or billing these items you at any time, or the Con-Rod Exchange, any time, included the tax or added on the tax on the invoice?

Mr. Winter: I object to that as calling for a conclusion. I think he can state just how he did bill—then it is up to the Court.

Q. State the fact about the billing, particularly with reference to the inclusion of any tax?

A. There was no tax added, if that is what you mean?

Q. That is what I mean.

Mr. Winter: We object to that as not responsive and a conclusion of the witness.

The Court: Motion denied.

Mr. Jones: That is all.

Cross Examination

By Mr. Winter:

Q. How did you arrive at your invoice price on your connecting rods, did you use the nationally advertised rod catalog or price list, isn't that a fact that you [82] did use a nationally advertised——?

A. (Interrupting) We took the prices from some of the locally advertised connecting rod prices; others, we just made—took them from the general market.

Q. You didn't bill the tax as a separate item or any tax as a separate item on your bills?

A. No additional tax.

(Testimony of Richard S. Seward.)

Q. But you accepted those prices of Clawson & Bals?

A. I never saw Clawson & Bals' prices.

Q. Whose did you use?

A. Pacific Coast concerns more—I don't know—Federal, Mogul, one other—one, I have forgotten, it was some concern in San Francisco.

Mr. Winter: That is all.

Redirect Examination

By Mr. Jones:

Q. State whether or not, at any time, prior to the audit that was made by the Agent here, you considered that any tax was due or claimed in connection with these transactions?

A. I never knew there was a tax until they came to us.

Mr. Jones: That is all.

Mr. Winter: That is all.

(Witness excused) [83]

L. HICKS TAYLOR

called as a witness on behalf of the plaintiffs herein being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. State your name?

A. L. Hicks Taylor.

(Testimony of L. Hicks Taylor.)

Q. And your business?

A. Public Accountant.

Q. What connection, if any, have you had with the Con-Rod Exchange?

A. Been Auditor for them since 1924.

Q. How closely have you kept in touch with the details of their business? A. Quite close.

Q. You make periodic visits to their plant, do you? A. Three, four, five times a year.

Q. Are you familiar with their methods of billing? A. I am.

Q. Are you familiar with their method of billing, with respect to exchanges or repairs of Con-Rods, during the period of 1932 to 1936?

A. From 1934 to 1936, I am familiar with it.

Q. State whether or not—or, state the fact with reference to the addition or inclusion of tax in the bills?

Mr. Winter: The bills are the best evidence of what they show.

The Court: The objection is sustained.

Mr. Jones: If Your Honor please, we can't very well go back to our customers and bring in the bills we may have submitted to them; they are not a part [84] of our records; if we sent a bill to a customer, we have no way of keeping that bill, but I think it is permissible to establish as a basic fact, it was not the practice of the office to include any tax on the bills or add it on to the bills.

The Court: He can testify what he saw. You are

(Testimony of L. Hicks Taylor.)

asking about bills. This man probably never saw a bill.

Mr. Jones: I appreciate, as to what the bill showed.

Q. Do you know what the practice of the Con-Rod Exchange was with reference to billing to its customers any tax on these Con-Rod exchanges or repairs?

Mr. Winter: The same objection.

Q. Just whether you know the practice or not.

The Court: Yes or no.

Q. Do you know their practice as to billing or not billing the tax?

A. They don't bill the tax.

Mr. Winter: I ask that be stricken.

Q. State whether you know the practice? Don't state what it is. If you know their practice?

A. The practice is——

The Court (Interrupting): Answer that question, whether you know. He is going to object——

Q. (Interrupting) I just asked whether you know what the practice was, not state what the practice was, but whether you know what the practice was? A. Yes.

Q. Then, I will ask you to state what the practice was? [85]

Mr. Winter: I object to that as not the best evidence.

The Court: Let him answer, to see how he arrived at that conclusion. It may be he can have some legitimate way to arrive at that conclusion.

(Testimony of L. Hicks Taylor.)

A. Our retained copies don't show any tax added.

Mr. Winter: I object to that and ask that it be stricken, he is talking about "copies", not the originals which are the best evidence.

Q. What do you mean by "retained copies"?

A. Exact duplicates of billing, we retain a copy of an exact billing and those duplicates don't show tax added.

The Court: I will overrule the objection.

Mr. Jones: That is all.

The Court: I will say, Mr. Jones, I don't think this testimony is of very great weight.

Mr. Jones: Mr. Seward already categorically——

The Court (Interrupting): Mr. Seward testified—as far as the accountant knows, they might have included it in the price and the accountant not know—all he is testifying to, what the records show on their duplicates; when they made out the bill, they didn't say "plus 10 percent tax" added.

Mr. Jones: I relied on Mr. Seward's testimony. I thought as Mr. Taylor was here, I would put him on.

That is all.

Mr. Winter: That is all.

(Witness excused) [86]

Mr. Jones: I offer the records in the previous case, Con-Rod Exchange, Inc. v. Henricksen, No. 8570, being Cause No. 8570, the records being the following: Pleadings and instruments, the amended

complaint, defendant's answer to the amended complaint, the opinion of the Court, the findings of fact and conclusions of law and the judgment.

Mr. Winter: We will object to it on the grounds that it is irrelevant and immaterial, not binding on the defendant in this case and that further, that the decision has been overruled by the Circuit Court of Appeals in the 9th Circuit, in effect, of the Armature case.

The Court: You are offering them as one exhibit?

Mr. Jones: Yes.

The Court: Plaintiff's 2?

Mr. Jones: Yes.

The Court: It may be admitted.

Plaintiff's Exhibit No. 2, Cause No. 8570, last above referred to, admitted in evidence and made a part of the record herein.

PLAINTIFF'S EXHIBIT No. 2

In the District Court of the United States for the
Western District of Washington, Northern
Division.

No. 8570

CON-ROD EXCHANGE, Inc., a corporation,
Plaintiff,

vs.

THOR W. HENRICKSEN, Acting Collector of
Internal Revenue,
Defendant.

Plaintiffs Exhibit No. 2 (Continued)

AMENDED COMPLAINT

Comes now the plaintiff and for its cause of action against the defendant alleges:

I.

That the plaintiff, Con-Rod Exchange, Inc., at all times hereinafter mentioned, was and now is, a corporation, organized, existing and doing business under and by virtue of the laws of the State of Washington, and that it has paid all fees due the State of Washington, including the license fee last past due. That its principal place of business is within the judicial district of the above-entitled court. That it is a citizen of the United States; and that it has at all times borne true allegiance to the Government of the United States, and that it has not in any way voluntarily aided, abetted or given encouragement to rebellion against said United States. That it is justly entitled to the amount herein claimed from the United States and that no assignment or transfer of said claim, or any part thereof, or any interest therein, has been made.

II.

That the defendant at all times hereinafter mentioned and since the 11th day of July, 1936, was and still is the Acting Collector of Internal Revenue of the United States for the Collection District of Washington, having an office and residing at Tacoma, Pierce County, within the above-entitled

Plaintiffs Exhibit No. 2 (Continued)

district, and that said defendant now is a citizen of the State of Washington, Pierce County therein.

III.

That for the period from October 1, 1935, to August 31, 1936, plaintiff paid to the said defendant any and all manufacturers' excise taxes due to the defendant or to the United States of America under Section 606(c) of the 1932 Revenue Act; that on or about April 27, 1936, the defendant, acting under the instructions of the Commissioner of Internal Revenue, notified the plaintiff that it was liable for a further assessment under the provisions of the said section of said Act, in the sum of \$234.84 additional tax, and \$11.74 penalty. That thereafter, acting under the authority of the Commissioner of Internal Revenue, the defendant, on the 26th day of August, 1937, required the plaintiff to, and thereupon it did, pay to the defendant the above set-forth sums, together with interest of \$8.22, or a total payment of \$254.80; and that on or about the same day, August 27, 1937, plaintiff duly filed with the defendant for transmission to the Commissioner of Internal Revenue its claim for refund and repayment of said amount, a full, true and correct copy of which claim is attached to the original complaint of plaintiff herein, marked Exhibit "A", and is by this reference made a part hereof and incorporated herein as fully as though set forth herein; that thereafter under date of November 10, 1937, the

Plaintiffs Exhibit No. 2 (Continued)

Commissioner of Internal Revenue, in writing, notified plaintiff that such claim was disallowed and rejected, a copy of which letter is attached to the original complaint of plaintiff herein, marked Exhibit "B", and is by this reference made a part hereof and incorporated herein as fully as though set forth herein.

IV.

That the plaintiff is engaged in the business of repairing automobile parts in the City of Seattle, King County, Washington; that the transactions upon which the tax above referred to was assessed were not sales of goods manufactured or produced by the plaintiff within the intent and purpose of Section 606 of the Revenue Act of 1932, but were repairs made to automobile connecting rods, which connecting rods at no time lost their identity as such and were thereafter re-installed in automobiles; and that the assessment of manufacturers' excise tax upon such connecting rods was wrongful, illegal and unwarranted, and plaintiff is entitled to the return thereof, together with interest.

V.

That the charge made by the plaintiff for repairing automobile parts was not changed or altered in any respect because of the assessment of the tax, refund of which is now being asked, and that the plaintiff did not include the tax in the price or charge of the repaired article, with respect to which

Plaintiffs Exhibit No. 2 (Continued)

it was imposed by the defendant, nor was the amount of the said tax collected, directly or indirectly, from the customers or vendees.

Wherefore, plaintiff prays for judgment against the defendant in the sum of \$254.80, together with interest thereon from and after the 26th day of August, 1937, at the rate of six per cent per annum until paid, together with its costs and disbursements herein.

WRIGHT, JONES & BRONSON
Attorneys for Plaintiff.

United States of America
Western District of Washington
Northern Division—ss.

Richard S. Seward, being first duly sworn, on oath deposes and says: That I am the president of the Con-Rod Exchange, Inc., a corporation, plaintiff above named; that I make this verification for and on its behalf, being thereunto duly authorized; that I have read the within and foregoing amended complaint, know the contents thereof, and believe the same to be true.

RICHARD S. SEWARD

Subscribed and sworn to before me this 18th day of March, 1938.

[Seal] A. P. BOWES

Notary Public in and for
Washington, residing in
Seattle.

Plaintiffs Exhibit No. 2 (Continued)

Copy received this 19th day of March, 1938

THOMAS R. WINTER

[Title of District Court and Cause.]

DEFENDANT'S ANSWER TO AMENDED
COMPLAINT

First Defense

The plaintiff's amended complaint fails to state a claim against the defendant upon which relief can be granted.

Second Defense

Defendant admits the allegations contained in Paragraph I of plaintiff's amended complaint except defendant denies that the plaintiff "is justly entitled to the amount herein claimed from the United States".

Defendant admits the allegations contained in Paragraph II of plaintiff's amended complaint.

Defendant admits the allegations contained in Paragraph III of plaintiff's amended complaint except defendant denies that "for the period from October 1, 1935, to August 31, 1936, plaintiff paid to the said defendant any and all manufacturer's excise taxes due to the defendant or to the United States of America under Section 606(c) of the 1932 Revenue Act".

Defendant denies the allegations contained in Paragraphs IV and V of plaintiff's amended complaint.

Plaintiffs Exhibit No. 2 (Continued)

Wherefore, defendant, having fully answered plaintiff's amended complaint, prays that the action be dismissed with costs to the defendant.

OLIVER MALM

Ass't United States Attorney.

J. CHARLES DENNIS

United States Attorney.

United States of America

Western District of Washington

Southern Division—ss.

Oliver Malm, being first duly sworn on oath, deposes and says that he is a duly appointed, qualified and acting Assistant United States Attorney for the Western District of Washington, Southern Division, and as such makes this verification for and on behalf of the defendant; that he has read the above and foregoing Answer to plaintiff's Amended Complaint, knows the contents thereof and that all the facts therein stated and allegations therein contained are true.

OLIVER MALM

Ass't United States Attorney

Subscribed and sworn to before me this 30th day of November, 1938.

[Seal] E. REDMAYNE

Deputy Clerk, United States
District Court.

Copy received this 30th day of Nov. 1938

H. B. JONES

Atty. for Pl.

[Endorsed]: Filed Nov. 30, 1938.

Plaintiffs Exhibit No. 2 (Continued)

[Title of District Court and Cause.]

OPINION

Appearances:

For the Plaintiff: Wright, Jones & Bronson
Seattle, Washington

For the Defendant:

J. Charles Dennis, U. S. Attorney
Oliver P. Malm, Thomas R. Winter
Deputy U. S. Attorneys
Seattle, Washington

Yankwich, District Judge:

Plaintiff seeks to recover the sum of \$254.80 paid upon a further assessment, under Section 606(c) of the Revenue Act of 1932 (Chapter 209, 47 Stats. 262), for the period from October 1, 1935, to August 31, 1936, made on the sale of automobile connecting rods, which the plaintiff rebabbitted and sold. A claim for refund, duly made by the plaintiff, was rejected by the Commissioner of Internal Revenue on November 10, 1937.

The rebabbing consisted in applying a metal alloy to the inside and edges of the bearing formed by the detachable cap and the large end of the shank of the rod. The method of doing the work was, in substance, this: Plaintiff purchased shanks from wrecking houses, either in Seattle or elsewhere, to establish a stock in a particular type of connecting rod. After a stock was once established, individual customers would bring in used shanks for rebabbing. If the plaintiff had in stock a rebabbitted

Plaintiffs Exhibit No. 2 (Continued)

connecting rod of the same size and type as the customer's, it was given in exchange to the particular customer. In the case of new automobile models, with new types of connecting rods, the plaintiff would purchase some new connecting rods from the automobile manufacturers. To rebabbitt the rod a used forging or shank, after the cap and the shank had been separated, was placed in a container of hot babbitt, which would melt off and dissolve the old babbitt still adhering to the old forging. The forging was then placed in an acid solution which cleaned off all grease and dirt. Then the new alloy was applied to the bearing by pouring, after which the surface of the new babbitt was evened so that the cap and the shank would fit together again. The inside of the new babbitted bearing was rough-bored to a size slightly smaller than what was to become the finished diameter, then a broaching occurred, which, finally, resulted in providing the prescribed diameters. The connecting rods were then placed in plaintiff's stock. (1)

It is the contention of the Government that the tax was properly collected, because the process of rebabbitting is one of manufacture.

I had occasion recently to consider the meaning of the words "manufacturer" and "producer" in Section 606(c) of the Revenue Act of 1932, in *Armature Exchange, Inc. v. United States*, 1938, D. C. Cal., 28 Fed Sup 10. I there held that the rewinding of automobile armatures was merely the repair or

Plaintiffs Exhibit No. 2 (Continued)

restoration of an article to its original state and not the "production" or "manufacture" of a new article.

It is the contention of the Government that the reasoning behind that decision does not apply here. Granting that my conclusion was correct, as to armatures, the Government insists that the process of rebabbitting, as here described, is really a process of manufacture and production of a new article from a shank which was nothing but scrap material.

The Government relies strongly upon *Clawson & Bals, Inc. v. Harrison*, D. C. Ill., Nov. 1938, 394 C.C.H. 9219.

I had occasion to comment on that decision in the foot note to the opinion in *Armature Exchange, Inc. v. United States*, *supra*. It is grounded upon a broad definition of "manufacture", which, to my view, is not warranted by the decisions on the subject.

In a case like this, where no binding precedents from higher courts exist to guide us, the resort to definitions is very helpful. But even that must be subordinated to the final, pragmatic test,—namely, the visual contrast between the appearance of the article before the process is applied to it and its appearance after the process is completed.

There is in evidence a used connecting rod in the form in which it usually comes to the plaintiff and a rebabbitted rod, after it has been processed by it. A look at the two shows that there has been no

Plaintiffs Exhibit No. 2 (Continued)

change in shape or identity of the rod. Its dimensions have remained the same. The only new part is a thin layer of metal alloy which has been applied to the bearing, smoothed out and the edges evened, so that the bearing will have the holding quality which had been lost in the old one through the wearing off of the old babbitt. The function of the shank is still the same. The operations are simpler than the operations resulting in the rewinding of armatures. The result achieved is less of a structural change than takes place when old armatures are rewound.

Occasionally, it is true, the bolts which connect the cap to the shank are replaced by bolts actually purchased by the plaintiff. But the business in which it is chiefly engaged is that of replacing the worn-out babbitt in the bearing of a new babbitt.

Whether we apply to the article which is finally sold the test of identity of structure or identity of function, the result is the same.

We do not have here a process of manufacture or production of an article of commerce. We have merely a process of renewing, for further use, a standard article of commerce,—an automobile part,—by resurfacing a worn-off portion of it with a thin layer of metal alloy, which, in all probability, does not enhance its weight by more than a few ounces.

“Manufacture is transformation,—the finishing of raw materials into a change of form for use.” (Kidd v. Pearson, 1888, 128 U. S. 1, 20)

Plaintiffs Exhibit No. 2 (Continued)

Here, there is no change of form, identity or function. The rehabilitated article is not a new article but one which has been restored to its original shape and use by the mere replacing of the worn off surface on part of it.

Certainly, if a retreaded tire in which the worn-off surface is replaced, so as to add four and one-half to five pounds weight over and above what the new tire weighed is not a process of manufacture (*Skinner v. United States*, 1934, 8 Fed Sup 999), the replacement of a thin film of metal which does not add more than a few ounces to the weight of the connecting rod is not manufacture. (See: *Hempy-Cooper Mfg. Co. v. United States*, 1936, 18 American Federal Tax Reports, 1313; *Bardet v. United States*, 1938, Prentice-Hall Federal Tax Current Court Decisions for 1938, Par. 5, 507).

It is unimportant that the connecting rod without the rebabbitting is useless as a connecting rod. And that through the process, something is made serviceable which was not so before, does not make the process one of manufacture. To consider "manufacturing" any process aiming to "make a serviceable product" (as does Judge Barnes in *Clawson & Bals, Inc. v. Harrison*, *supra*) would call for inclusion of all repairing.

For the function of repairing is to make useable an article which without it could not be used. A frying pan without a handle is useless as a frying pan. So is a chair in which the seat or a leg is

Plaintiffs Exhibit No. 2 (Continued)

broken. The workman who adds a new handle to a pan, or repairs the seat or leg of a chair by replacing the worn out portion with new materials, in effect, takes something out of a scrap heap or a junk pile and restores it to usefulness.

Still we would be doing violence to the English language if we called these acts of repairing acts of manufacture.

The rehabilitated connecting rod competes in the open market with new connecting rods. And were we dealing with a sales tax it could be held that, regardless of method of production, the ultimate act is a sale in both instances. But the tax assessed is an excise tax, not a sales tax.

It is imposed on the sale only if the seller is a producer or manufacturer.

The final test is, therefore, not whether there was a sale, but whether there was a sale by a manufacturer or producer.

In my view, the plaintiff was not a manufacturer or producer either when it rebabbitted rods brought in by others and returned the identical rod (as it did in 75 per cent of its sales during the period) or when it exchanged an old rod on which the babbitt had worn off for a newly rebabbitted one (as it did in 25 per cent of its sales).

The assessment was, therefore, illegally levied.

Section 621 of the Revenue Act of 1932 reads (in part):

“(d) No overpayment of tax under this title shall be credited or refunded (otherwise

Plaintiffs Exhibit No. 2 (Continued)

than under subsection (a), in pursuance of a court decision or otherwise, unless the person who paid the tax establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, (1) *that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee,* or (2) *that he has repaid the amount of the tax to the ultimate purchaser of the article, or unless he files with the Commissioner written consent of such ultimate purchaser to the allowance of the credit or refund.*" (Italics added)

The object of provisions of this character is to prevent unjust enrichment by taxpayers who might seek recovery of a tax which had been absorbed into the price of the article sold. Rightly. For if the taxpayer has shifted this tax onto others, they and not he paid it. And the tax refunding statutes, being equitable in nature, the law would be aiding inequity if it allowed recovery by one who, although he has, apparently, paid the tax, has, actually, forced another to do so. (United States v. Jefferson Electric Co., 1934, 291 U. S. 386, 402; Union Pacific Packing Co. v. Rogan, 1937, D. C. Cal, 17 Fed Sup. 934, 942; Anniston Mfg. Co. v. Davis, 1937, 301 U. S. 337, 348; White Packing Co. v. Robertson, 1937, 4 Cir. 89 Fed (2) 775, 780-81).

The evidence shows that the sales of rebabbitted rods were made at prices fixed by larger competi-

Plaintiffs Exhibit No. 2 (Continued)

tors who published, regularly, price lists. This was maintained at all times. Even after the audits made by the agents of the Internal Revenue Department and which resulted in the additional assessment, no change was made to include the additional taxes that might be assessed against them. An executive officer of the plaintiff testified positively that at no time was the price fixed by himself or anyone connected with the company so as to include the tax.

Some of the price lists which the plaintiff sought to meet show that the particular competitor had included the excise tax in the price. There is no showing that plaintiff was aware of that fact. But even if there were, it could not be held to outweigh the positive statements that a possible excise tax was not in contemplation when the price was fixed.

Two merchants may sell the same article at the same price, and yet entirely different elements might enter into the determination of the price. A large dealer, engaged in rebabbitting on a national scale, with a large factory doing the repairing, would have a lower cost, enabling him to absorb the excise tax and still compete with a smaller dealer, like the plaintiff, whose cost of production must be higher and who does not absorb the tax. So the argument from identity of *price of* little help.

I am of the view that the plaintiff has satisfied the requirement of the section and has shown that the tax was not passed on to the consumer.

Plaintiffs Exhibit No. 2 (Continued)

Judgment will be for the plaintiff as prayed for in the Complaint, subject to correct computation of amounts to be made by the parties.

Dated this 17th day of August, 1939.

LEON R. YANKWICH,

United States District Judge.

Note 1:

There is no disagreement between the Government and the taxpayer, either as to the nature of the work done on the rods by the plaintiff or the structural result.

The Government's brief has this description:

"The connecting rods are steel forgings consisting of a shank and a cap and two bolts with nuts uniting the said shank and cap. The larger end of the rod contains the bearing, consisting of a babbitt alloy integrally cast and permanently bonded to the shank and cap of the rod. The babbitt alloy being a soft metal, the bearing in use is subject to destruction by reason of cutting, wearing and burning out. The plaintiff corporation removes the destroyed babbitt alloy from the shank and cap, leaving the shank and cap in its entirety. Babbitt alloy is then replaced in the shank and cap, and after the refilling with the babbitt, the babbitt alloy is machined to obtain a smooth surface, and is clamped or fastened into the shank and cap with the original screws.

In some instances, a process of 'rebushing' is necessary in the small end of the connecting rod,

Plaintiffs Exhibit No. 2 (Continued)
and when necessary new bolts and nuts and shims
are supplied.”

[Printer’s Note: Here follows Findings of Fact
and Conclusions of Law which is set out at page
20 and Judgment which is set out at page 31 of
this printed record.]

[Endorsed]: Filed Aug. 17, 1939.

Mr. Jones: As far as the issue of res judicata,
that is all the evidence we will have on that point,
and if we can submit that issue, then the matter of
going into these details, the parties can get together
on it and see what they can do on it.

The Court: Mr. Winter, do you have any tes-
timony on this question? [87]

Mr. Winter: No, your Honor, except I take it
the Court will take judicial notice of the decision
of the Circuit Court of Appeals in the Armature
Case? If that is understood, I won’t offer it.

The Court: Yes.

Mr. Jones: Your Honor, will you take a recess
during the course of the morning?

The Court: I take short recesses. I thought you
could bring the gentlemen in and the records and
I will give them a room. * * *

We will take a recess until you gentlemen in-
form me you are ready on the next case. Then

try to get this, so by Noon, they will be able to report back.

Recess.

Mr. Jones: After conferring in this matter, Your Honor, we have decided on the disposition of the details of this. If the rule of *res judicata* applies, then of course, it really doesn't make any difference how much of this is exchange and how much repairs, because it all falls under the previous decision and the plaintiff is really the one taking the chance on not making up that record and, confronted with a number of these transactions, we decided that it was just too much to endeavor to go into it and we are going to present no evidence on that point, except on one phase of it and that is to show how much of the assessment relates to the period where there were no records and where the witness said there was just [88] an estimate, based on what was found in other years and carried back; that might have some bearing if the *res judicata* should be overthrown.

We will ask Mr. Evans to take the stand and establish that point and then we will just introduce no evidence on the other.

PHILLIP EVANS,

recalled.

Direct Examination

By Mr. Jones:

Q. You have been sworn. Just take the stand. I want to have you state for the purposes of the rec-

(Testimony of Phillip Evans.)

ord, how much of the tax that you set up against the plaintiffs was for the period when there were no records and what is based on purely an estimate, as you said in your earlier testimony? I think that sheet will show, that is taken from the Plaintiffs' Exhibit 1. (Indicating)

A. The period we set up on an estimated base was the years 1932 and 1933.

Q. And how much was the amount of sales that you estimated for that period as subject to taxation?

A. Amount of sales for 1932 was \$10,015.97.

Q. And for 1933?

A. For 1933, it was \$18,977.64.

Q. And how much were the taxes based on those estimates?

A. The taxes for 1932 was \$200.31 and the penalty was \$50.09.

Q. Was there a figure for interest, also?

A. There was a figure for interest also, \$67.47. [89]

Q. What was the tax penalty and interest for 1933?

A. 1933, the tax was \$379.56, the penalty \$94.90 and the interest \$92.99.

Q. Now, as I understand it, you had no records at all, supporting those figures?

A. No, sir.

Q. And you arrived at them merely by some process of apportionment or estimates based on subsequent years' business?

A. Yes.

Mr. Jones: That is all.

(Testimony of Phillip Evans.)

Cross Examination

By Mr. Winter:

Q. Referring to what has been marked for identification, Mr. Evans, as Plaintiffs' 1, you make a statement "We further find no records available for 1932 and 1933. In order to establish the tax, the average per month was taken for the tax obtained for the years 1934 and 1935 and used that as a basis for the tax arrived at for the years 1932 and 1933", is that a fact? A. Correct.

Q. And that is what you found?

A. Correct.

Mr. Winter: That is all.

Mr. Jones: That is all, Mr. Evans.

(Witness excused) [90]

Mr. Jones: Do you want these in the record, Mr. Winter? (Indicating) I don't think I will offer this unless you want it in.

Mr. Winter: No, I don't want it in. (Referring to Plaintiffs' Exhibit No. 1, marked for identification.) You had better leave them in the file, then.

Mr. Jones, Marked for identification; that is a part of it. (Indicating) I am not going to offer them, in view of the determination arrived at.

Mr. Winter, in our complaint we set up the payments that were made and you admitted the correctness of the amounts but said that there was some difference as to the dates of payment. We have discussed the matter and I understand that it is stipu-

lated that the amounts as set up are correct and may be accepted as a basis for a judgment and that between us, we will make the proper computation—when we figure out the details and judgment, is that acceptable as a stipulation?

Mr. Winter: All except we don't want to stipulate for a judgment, but the only difference, it is understood the only difference between us, as to the dates of the payments; the amounts are correct but there are just a few little discrepancies, one or two days, and we think that will and can be adjusted, in the event of a judgment against the defendant.

Mr. Jones: On that basis, the plaintiffs rest.

Mr. Winter: We have no testimony, Your Honor.

Mr. Jones: Mr. Hooper tells me it will be desirable to introduce copies of the portion of the [91] Court records I offered as an Exhibit. May it be stipulated we may furnish copies?

Mr. Winter: Yes, no objection to furnishing copies.

The Court: I don't want Counsel on either side to feel I decided this case, rushed it through, in the matter of a decision; the fact is, I spent all day yesterday and last evening examining authorities submitted in briefs in this case and the other case set for today, but it seems to me this is a case in which the rule of *res judicata* is peculiarly applicable.

You have a transaction where taxes were computed over a period of a number of years, or as Mr. Jones indicated in his opening statement, the fact that the period from October 1935 until August, the

end of August 1936, was selected as a period which (to submit the matter to Judge Yankwich) isn't binding upon the Government as, apparently, no stipulation that would be binding on them as to the other years, but it is apparent to me that this particular period was selected and that it was the intention of the parties at the time that one period was submitted, that that was more or less a representative period out of the entire period, 1932 to 1938, inclusive, and Judge Yankwich decided that case——

Mr. Winter (Interrupting): Do I understand Your Honor is also ruling that decision is *res judicata* on the United States, with respect to the proof necessary, that they sustain the burden and didn't pass it on?

Of course, we want the Court to understand we haven't waived that contention that there is no evidence [92] here that the defendant did not pass on the tax.

The Court: Well, no, I am not ruling that decision by Judge Yankwich is *res judicata* as to that question, on that question, the testimony here that the plaintiffs did not pass on the tax of the corporation and there is no testimony to controvert it. I find as a matter of fact, they did not pass on any tax; that the billings were made on a basis according to the testimony of Mr. Seward of some prices, nationally advertised connecting rods, and they took the position all the way through there was no tax upon these transactions and didn't add anything to the

price on the basis of the tax—find as a matter of fact, there was no tax passed on; but, the Government had a right to appeal from Judge Yankwich's decision and didn't do so and I am convinced that under this case of 298 U. S. Tate case, or 289, Tate case, that the same theory is applicable here—the desirability of the prevention of duplication of litigation.

I will enter judgment for the plaintiffs in the amount that you will agree upon, according to your stipulation.

Mr. Winter: Your Honor, in that connection—I presume you will prepare findings, Mr. Jones?

Mr. Jones: Yes.

Mr. Winter: We will attempt to approve them and send them over to Spokane to Your Honor, or would Your Honor wish to—I don't know how long it will take.

Mr. Jones: We will do it as expeditiously as possible. [93]

The Court: There is a possibility I will be back the last of this month.

Mr. Winter: If Your Honor isn't here, we can mail them over?

The Court: Yes.

Mr. Jones: I might say, if Your Honor is interested in keeping any record of authorities in cases of this kind, that while we didn't cite this as a tax, there is an article on Res Judicata in Federal Taxation by Paul, who is a recognized authority which appears in his Selected Studies—Federal Taxation, 2d Series, I don't think we cited it as an authority,

but a great deal of the information in our brief is taken from it. I thought Your Honor might like to have that memorandum.

The Court: What is the Page?

Mr. Jones: Page 104.

The Court: All right.

(Adjournment) [94]

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

I, Judson W. Shorett, Clerk of the District Court of the United States for the Western District of Washington, do hereby certify and return that the foregoing Transcript of the Record on Appeal, consisting of pages numbered 1 to 94, inclusive, is a full, true and correct copy of so much of the record, papers and proceedings in Cause No. 174, Richard S. Seward and Helen Roberts, Liquidating Trustees of Con-Rod Exchange, Inc., a corporation, Plaintiffs and Appellees vs. Thor W. Henricksen, Acting Collector of Internal Revenue, Defendant and Appellant, as required by the Designation of the Contents of the Record on Appeal, on file and of record in my office at Tacoma, Washington, the same constituting the Transcript of the Record on Appeal from the Judgment of the District Court of the United States for the Western District of Washington, Southern Division, to the United States Circuit Court of Appeals for the Ninth Circuit.

I do further certify that the original exhibits, numbered as follows, to-wit: Plaintiffs' Exhibits Nos. 1 and 2, are transmitted herewith pursuant to order of the District Court herein.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said Court, at the City of Tacoma, State of Washington, this 27th day of August, 1942.

[Seal]

JUDSON W. SHORETT,

Clerk.

By E. REDMAYNE,

Deputy.

[Endorsed]: Filed Aug. 26, 1942.

[Endorsed]: No. 10235. United States Circuit Court of Appeals for the Ninth Circuit. Thor W. Henricksen, Acting Collector of Internal Revenue, Appellant, vs. Richard E. Seward and Helen Roberts, Liquidating Trustees of Con-Rod Exchange, Inc., a Corporation, Appellees. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Southern Division.

Filed August 31, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 10235

RICHARD E. SEWARD and HELEN ROBERTS,
liquidating trustees of CON - ROD EX-
CHANGE, INC., a corporation,

Appellee,

v.

THOR W. HENRICKSEN, Acting Collector of
Internal Revenue,

Appellant.

APPELLANT'S STATEMENT OF POINTS
AND DESIGNATION OF RECORD FOR
PRINTING

Comes Now Thor W. Henricksen, Acting Collector of Internal Revenue, appellant above named, and for his statement of points upon which he intends to rely on this appeal adopts the statement of points filed by him in the District Court in connection with his Notice of Appeal and included in the transcript of record prepared and certified by the Clerk of said District Court at page 42 thereof; and appellant designates the entire transcript of record as prepared and certified by the Clerk of said Court and all of plaintiff appellee's Exhibit 2 except the Judgment, Findings of Fact and Conclusions of Law of said exhibit which are attached and made a part of plaintiff appellee's complaint which is included in the transcript of

record prepared and certified by the Clerk as necessary for the consideration of this appeal.

J. CHARLES DENNIS,
HARRY SAGER,
THOMAS R. WINTER,
Attorneys for Appellant.

[Endorsed]: Filed Aug. 31, 1942.

[Title of Circuit Court of Appeals and Cause.]

APPELLANT'S AMENDED STATEMENT OF
POINTS AND DESIGNATION OF REC-
ORD FOR PRINTING

Comes Now Thor W. Henriksen, Acting Collector of Internal Revenue, appellant above named, and amends his Statement of Points and Designation of Record for Printing heretofore filed herein by adding the following:

IX.

The United States District Court erred in making and finding (Finding of Fact X) that the corporation upon behalf of which this action is brought did not include the excise taxes in its sales prices and did not collect said taxes or any part thereof from its vendees and that therefore the burden of said taxes was borne solely and exclusively by the corporation and the burden of none of said taxes was passed on by said corporation to its customers

or vendees and the evidence failed to support such findings.

X.

The United States District Court erred in overruling all of the Government's objections and motions appearing on pages 36, 39, 40 and 41 of the original reporter's trial transcript.

J. CHAS. DENNIS

J. Charles Dennis,

United States Attorney.

HARRY SAGER,

Ass't United States Attorney.

THOMAS R. WINTER,

Special Assistant to the Chief

Counsel for the Bureau of

Internal Revenue,

Attorneys for Appellant.

Copy received this 3rd day of September, 1942, and it is hereby stipulated that the appellant's Statement of Points and Designation of Record for Printing may be so amended.

JONES & BRONSON,

H. B. JONES,

Attorneys for Appellee.

[Endorsed]: Filed Sep. 4, 1942.

No. 10235

IN THE
United States
Circuit Court of Appeals
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Appellant

v.

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Liquidating Trustees of CON-ROD
EXCHANGE, INC., a Corporation,

Appellees

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED
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SOUTHERN DIVISION

HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
SAMUEL H. LEVY,
GEORGE H. ZEUTZIUS,
*Special Assistants to the
Attorney General.*

J. CHARLES DENNIS,
United States Attorney.

HARRY SAGER,
*Assistant United States
Attorney.*

THOMAS R. WINTER,
*Special Assistant to
the Chief Counsel.*

FILED

NOV 10 1941

PAUL P. O'BRIEN,
CLERK

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*Assistant United States
Attorney.*

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IN THE
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HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

OPINION BELOW

The District Court rendered no opinion but entered special findings of fact and conclusions of law which are unreported. (R. 52-61.)

JURISDICTION

This is an appeal from a judgment of the District Court entered March 4, 1942 (R. 61-62), and cor-

rected pursuant to stipulation on May 8, 1942 (R. 63-65), in favor of appellees in an action brought by them on September 28, 1940, pursuant to the provisions of Section 24, Fifth, of the Judicial Code for the refund of \$2,286.88 assessed and paid as manufacturers excise taxes for the periods June 21, 1932, to September 30, 1935, and October 1, 1936, to September 30, 1938, pursuant to Section 606(c) of the Revenue Act of 1932. Appellees were the last directors and liquidating trustees of Con-Rod Exchange, Inc., a Washington corporation.

Refund claims were filed on February 17 and April 11, 1940, within four years after the date of payment, and were rejected by the Commissioner of Internal Revenue on April 18 and July 31, 1940, respectively. (R. 56.)

Notice of appeal was filed June 1, 1942 (R. 65), and an order was entered by the District Court on July 7, 1942 (R. 66), extending the time for 90 days within which to file and docket the record on appeal. The jurisdiction of this Court is invoked under Section 128(a) of the Judicial Code, as amended.

QUESTIONS PRESENTED

1. Whether sales of automobile connecting rods by the taxpayer corporation were taxable under Section 606(c) of the Revenue Act of 1932, which im-

posed a tax upon automobile parts "sold by the manufacturer, producer, or importer" thereof.

2. Whether under the circumstances involved a prior decision for taxpayer respecting taxes paid on similar articles produced and sold during a different period was *res judicata* with respect to this action.

3. Whether there was competent evidence to support the court's finding that the burden of the taxes was borne by the corporation and not passed on to its vendees or purchasers.

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*.

STATEMENT

This case was tried to the court without a jury upon the pleadings, testimony of four witnesses offered by taxpayer, certain oral stipulations during the trial, and documentary exhibits. The Government offered no evidence. The court entered findings of fact and conclusions of law (R. 52-61) in favor of taxpayers.

The District Court's findings of fact may be summarized as follows:

At all times herein mentioned prior to January 8, 1940, Con-Rod Exchange, Inc., the corporation on behalf of which the suit was brought, was a corporation organized, existing and doing business under the laws of the State of Washington. It was legally dissolved on January 8, 1940. The appellees, Richard E. Seward and Helen Roberts, were its last directors and liquidating trustees, and this cause of action thereby vested in them. (R. 53-53.)

In 1936 the corporation was determined to be liable for an assessment of manufacturers' excise taxes in the principal sum of \$2,019.64, and for interest in the sum of \$188.28, under the provisions of Section 606(c) of the Revenue Act of 1932. This assessment was for excise taxes for the period from June 21, 1932, to September 30, 1935, upon the manufacture and sale by the corporation of certain automobile parts, to-wit, connecting rods. A further assessment was determined for the period from October 1, 1936, to September 30, 1938, in the amount of \$78.96. (R. 53-54.) These taxes were paid on divers dates from November 16, 1936, to March 22, 1940. (R.54-56.) Claims for refund were filed and were disallowed by the Commissioner on April 18, 1940, and July 31, 1940. (R. 56.)

On August 9, 1939, an action was tried in the same court before Judge Leon R. Yankwich, in which Con-Rod Exchange, Inc., sought to recover from the Collector of Internal Revenue manufacturers' excise taxes assessed and collected under Section 606(c) of the Revenue Act of 1932 for the period from October 1, 1935, to August 31, 1936. The court, on August 30, 1939, made findings of fact and conclusions of law, and thereupon entered judgment in favor of the plaintiff corporation. (R. 56.) *Con-Rod Exchange, Inc. v. Henricksen*, 28 F. Sup. 924 (W. D. Wash.) ¹

The court found that the type of material used in the operations of this corporation, the physical process of "rebabbitting" the connecting rods, and the basis upon which the business was conducted, were identical in their nature during the periods involved in this action and in the preceding suit, ² except that

¹ Plaintiff's Exhibits No. 2, consisting of the amended complaint, defendant's answer, opinion of the court, findings of fact, conclusions of law and judgment in the prior proceeding (R. 111-128), was admitted in evidence over the objection of Government counsel (R. 112).

² Finding IX in the prior action was in material part as follows (R. 25-26):

The rebabbitting consisted in applying a metal alloy to the inside and edges of the bearing

it was stipulated that all of the taxes herein involved were levied upon transactions in which customers of the corporation exchanged old connecting rods on which the babbitts had been worn, for newly rebabbitted one or "exchange sales" similar to those which constituted the largest part of the corporation's busi-

formed by the detachable cap and the large end of the shank of the rod. * * * Plaintiff purchased shanks from wrecking houses, either in Seattle or elsewhere, to establish a stock in a particular type of connecting rod. After a stock was once established, individual customers would bring in used shanks for rebabbing. If the plaintiff had in stock a rebabbitted connecting rod of the same size and type as the customer's, it was given in exchange to the particular customer. In the case of new automobile models, with new types of connecting rods, the plaintiff would purchase some new connecting rods from the automobile manufacturers. To rebabbitt the rod a used forging or shank, after the cap and the shank had been separated, was placed in a container of hot babbitt, which would melt off and dissolve the old babbitt still adhering to the old forging. The forging was then placed in an acid solution which cleaned off all grease and dirt. Then the new alloy was applied to the bearing by pouring, after which the surface of the new babbitt was evened so that the cap and the shank would fit together again. The inside of the new babbitted bearing was rough-bored to a size slightly smaller than what was to become the finished diameter, then a broaching occurred, which, finally, resulted in providing the prescribed diameters. The connecting rods were then placed in plaintiff's stock.

ness during the period involved in the prior suit.³ The court further found that all other material facts involved in the present action were also involved in the preceding action heard by the court below, excepting only the amount of the assessment of and the time of the payment of the taxes, the refund of which is herein sought; the period of time for which they were assessed by the Collector; and the time of the filing by the corporation of the claim for refund in accordance with the Internal Revenue Code and the regulations of the Commissioner of Internal Revenue. (R. 57.)

The court in the prior cause found that the larg-

The used connecting rod consisted primarily of a forging formed by a shank and cap fastened together by bolts, which formed an opening constituting the bearing intended to contain a bab-bitted surface. * * *

Judge Yankwich in a footnote to his opinion stated, in adopting a portion of the Government's brief, as follows (R. 127-128):

In some instances, a process of "rebushing" is necessary in the small end of the connecting rod, and when necessary new bolts and nuts and shims are supplied.

³ The reference to the largest, rather than the smallest, part of the corporation's business involved in the prior suit was obviously an inadvertent error. (See R. 27.)

est part of the assessment of those excise taxes was made with respect to sales by this corporation of rebabbitted connecting rods; that the rebabbitting process performed by the taxpayer therein upon the connecting rods, and in respect to which the excise taxes therein involved were imposed, whether on an "exchange basis" or on a basis wherein customers received back their own repaired rods, constituted the repair, rehabilitation or reconditioning of used and second-hand connecting rods; that the sale of rebabbitted connecting rods did not constitute sales of automobile parts or accessories by a manufacturer, producer or importer in any instance; that the taxpayer corporation did not include the excise taxes in the price of the articles with respect to which the taxes were imposed and it did not collect the amount of the taxes or any part thereof from the vendee or vendees of the articles in respect to which the taxes were imposed. (R. 57-58.)

The court concluded that the taxpayer corporation was not, during the times involved in that suit, the manufacturer, producer or importer of automobile connecting rods or of any automobile parts or accessories whatsoever within the meaning of Section 606 of the Revenue Act of 1932; and that the excise tax imposed by Section 606(c) of the Revenue Act of

1932 did not apply to sales to rebabbitted automobile connecting rods by one who acquired such rods second-hand and rebabbitted the same and who neither manufactured, produced nor imported any other automobile parts or accessories. The court thereupon entered judgment for the taxpayer in the principal amount of the taxes assessed for the period therein concerned. That judgment now is and stands unreversed and unmodified and in full force and effect. (R. 58-59.)

The court in the instant case further found that the corporation did not include the excise taxes here in question in the price of the articles with respect to which the tax was imposed; that it did not collect the amount of the taxes or any part thereof from the vendee or vendees of the articles in respect to which the taxes were imposed; and that the burden of the taxes was borne solely and exclusively by the corporation and the burden of none of the taxes was passed on by the corporation to its customers or vendees.⁴ It concluded that the prior decision in the *Con-Rod Exchange, Inc.*, case *supra*, was *res judicata* in this cause with respect to whether or not the taxes were properly assessed and collected, and that therefore the corporation was not during the time involved in this

⁴ The testimony upon which these findings were made was admitted over objection of Government counsel. (R. 107, 108, 110-111, 139.)

suit the manufacturer, producer or importer of automobile connecting rods within the meaning of Section 606 of the Revenue Act of 1932. (R. 60.) Judgment was thereupon entered for the appellees. (R. 61-64.)

STATEMENT OF POINTS TO BE URGED

Appellant relies upon all of the points set forth in the record (pp. 67-69, 137-139). The main points are that the District Court erred in determining (1) that the sales of connecting rods by the corporation during the taxable period involved herein were not sales of automobile parts or accessories by a manufacturer or producer thereof within the purview of Section 606(c) of the Revenue Act of 1932; (2) that the previous decision by Judge Yankwich on August 17, 1939, is *res judicata* in this cause with respect to the issue of taxability; and (3) that the burden of none of the taxes was passed on by the corporation to its customers or vendees.

SUMMARY OF ARGUMENT

Processes and operations substantially similar if not identical with those of the taxpayer corporation were held by this Court in *United States v. Arma-*

ture Exchange, 116 F. (2d) 969, *United States v. J. Leslie Morris Co.*, 124 F. (2d) 371, and *United States v. Moroloy Bearing Service*, 124 F. (2d) 373, to constitute production of automobile parts within the meaning of the taxing statute. Under these authorities the decision obtained by the taxpayer corporation in the earlier case of *Con-Rod Exchange, Inc., v. Henricksen*, 28 F. Supp. 924 (W. D. Wash.), is admittedly no longer law. That case involved different transactions occurring in a different period of time. Therefore, it should not be held to be *res judicata* here.

Moreover, the District Court's finding that the corporation bore the burden of the tax which it seeks to have refunded is not supported by the evidence. The taxpayers could not in any event recover unless this fact had properly been established.

The court erred in admitting in evidence over objection various records taken from the previous action and in overruling objections to certain testimony given by the taxpayers' witnesses. The judgment, ultimate findings and conclusions of the court below are not supported by the evidence, are erroneous and should be reversed.

ARGUMENT

I.

THE TRANSACTIONS INVOLVED CONSTITUTE SALES OF AUTOMOBILE PARTS BY THE MANUFACTURER OR PRODUCER THEREOF WITHIN THE MEANING OF THE TAXING STATUTE AND UNDER THE REASONING OF A LONG LINE OF FEDERAL COURT DECISIONS.

Taxpayers, by their counsel, admitted during the trial that the principle of the prior decision obtained by their corporation was overruled by this Court in the *Armature* case [*United States v. Armature Exchange*, 116 F. (2d) 969, certiorari denied, 313 U. S. 573].⁵ (R. 83.) It was also agreed (R. 77) and the court so found (R. 57) that the connecting rods alleged to have been "rebabbitted" by taxpayer corporation were sold by it on the *exchange basis of sale* for automotive replacement parts. No evidence was offered tending to establish that any of the taxed transactions were mere repair jobs (R. 129), as were a majority of the transactions involved in the prior case.

⁵ The Government did not appeal the prior decision primarily because of the small amount involved (\$254.80) and the fact that the *Armature Exchange* case, likewise decided by Judge Yankwich, was pending as a test case.

Under the present state of the law, therefore, the automobile connecting rods involved in this action admittedly were produced and/or manufactured by the taxpayer corporation, as well as sold by it during the periods June 21, 1932, to September 30, 1935, and October 1, 1936, to September 30, 1938, fall within the purview of Section 606(c) of the Revenue Act of 1932, and were subject to tax liability thereunder. This conclusion follows, not only from this Court's decision in the *Armature Exchange* case, *supra*, but also from the following cases all of which arose under the same taxing section and involved comparable facts and similar contentions:

United States v. J. Leslie Morris Co., 124 F. (2d) 371 (C.C.A. 9th), involving "rebabbitted" connecting rods;

United States v. Moroloy Bearing Service, 124 F. (2d) 373 (C.C.A. 9th), involving "rebabbitted" connecting rods;

United States v. Armature Rewinding Co., 124 F. (2d) 589 (C.C.A. 8th), involving "rewound" armatures and "rebuilt" generators;

Clawson & Bals v. Harrison, 108 F. (2d) 999 (C.C.A. 7th), certiorari denied, 309 U. S. 685, involving "rebabbitted" connecting rods;

Edelmann & Co. v. Harrison (N.D. Ill.), decided April 7, 1939 (1939 Prentice-Hall, par 5, 379), involving "rewound" armatures and "rebuilt" generators;

Federal-Mogul Corp v. Smith (S.D. Ind.), de-

cided February 23, 1940 (1940 Prentice-Hall, par. 62, 510), involving "rebabbitted" connecting rods;

Moore Brothers, Inc. v. United States (N.D. Tex.), decided May 14, 1940 (1940 Prentice-Hall, par. 62, 676), involving "rebuilt" armatures;

Motor Mart v. United States (N.D. Tex), involving "rebuilt" generators and armatures, was decided for the Government on May 14, 1940, without opinion (Civil Action No. 239);

Replacement Unit Co. v. United States (N. D. Ohio), decided December 17, 1941 (1942 Prentice-Hall, par. 62, 388), involving "rebuilt" automobile clutch pressure assemblies;

Carty Electric & Armature Service, Inc. v. United States (Colo.), decided February 13, 1942 (1942 Prentice-Hall, par. 62, 562), involving "rebuilt" armatures;

Niagara Motors Corp. v. McGowan, 45 F. Supp. 346 (W.D. N.Y.), involving "rebabbitted" connecting rods;

Southern Armature Works v. United States (N.D. Ala.), decided September 10, 1942, involving alleged repaired and rebuilt armature and generators. Judgment entered for Government following the sustaining of its motion to dismiss. Not reported.

The decisions of the Canadian courts are in harmony with those of our own, cited above:

Biltridge Tire Co. v. The King, 1937 Canada Law Rep. 364, arose under the War Revenue Act of 1927, and involved language similar to that used in Section 606(c) of the United States

Revenue Act of 1932. The Supreme Court of Canada held that so-called "retreaded" automobile tires were subject to tax upon their sale by the retreader which contended it was not the manufacturer or producer thereof;

The King v. Biltrite Tire Co., 1937 Canada Law Rep. 1, is the preceding case in the lower court. The court reviewed various American decisions and rejected the retreaded tire case of *Skinner v. United States*, 8 F. Supp. 999 (S.D. Ohio);

The King v. Boulton, Ltd. [1938], 3 Dominion Law Rep. 664, involved "retreaded" automobile tires made by the taxpayer on a small scale. These were held taxable. Taxpayer also did considerable retreading of tires for customers to whom the tires were returned. The latter transactions were not sought to be taxed because they did not involve a sale of the completed article but merely a contract for the furnishing of materials and labor.

It should be observed that the correctness of the principle established by the foregoing decisions was approved by Congress when it refused to exempt in the Revenue Act of 1941 rebuilt automobile parts from the payment of manufacturers' excise tax. The Senate Committee on Finance in its report on this subject (S. Rep. No. 673, Part 1, p. 48, 77th Cong., 1st Sess.) said, in part:

There are several decisions of the United States Circuit Courts of Appeals holding rebuilt parts and accessories to be subject to the manufacturers' tax. Rebuilt parts compete with new parts, and it appears appropriate that they should

be subject to the same tax. Accordingly, no change has been made.

Even more recently it was again attempted by representatives of members of the automotive replacement parts industry, within which category the taxpayer corporation falls, to amend the section so as to exclude such parts from tax. (See House Hearings before Committee on Ways and Means, 77th Cong., 2d Sess., Revenue Revision of 1942, Vol. 2, pp. 1907-1921; also Senate Hearings before Committee on Finance, 77th Cong., 2d Sess., Revenue Act of 1942, Vol. 1, pp. 1143-1152.) However, no amendments were made, and the 1942 Revenue Act was enacted leaving the taxing provision in question in full force and effect, with the five per cent rate provided by Section 3403(c) of the Internal Revenue Code, as amended by Section 209 of the Revenue Act of 1940, c. 419, 54 Stat. 516, and Section 544 of the Revenue Act of 1941, c. 412, 55 Stat. 687. Under Section 544 *supra*, the tax rate on auto parts and accessories was raised to five per cent, whereas during the time involved in the present suit it was two per cent.

II.

THE DOCTRINE OF *RES JUDICATA* IS INAPPLICABLE TO THE INSTANT ACTION UNDER THE FACTS AND CIRCUMSTANCES DISCLOSED, PARTICULARLY IN VIEW OF THIS COURT'S INTERVENING DECISIONS

The court below did not disagree with the foregoing conclusions. Its decision was based upon the ground that the prior decision involving the application of this tax for different periods of time was *res judicata*. Accordingly, irrespective of the correct interpretation of the statute generally, this corporation, under the court's decision, would not be a "manufacturer" subject to the tax. We submit that this was an erroneous application of the doctrine of *res judicata*.

The precise issue in this case is whether or not the corporation was a manufacturer or producer during the periods June 21, 1932, to September 30, 1935, and October 1, 1936, to September 30, 1938, with respect to the automobile parts it sold. The corporation's activities in these periods were not those of the period October 1, 1935, to August 31, 1936, previously litigated. They were comparable and similar in nature but the sales transactions, the articles sold, and the production operations were completely differ-

ent events. They were not the same set of events litigated in the earlier action.

This proceeding involves a different claim or demand. It is not a reassertion of the identical claim or demand (for \$254.80) involved in the previous action. Different facts are involved, although they may be in many respects similar in nature. The issue of whether or not the corporation passed on the taxes (of \$2,286.88) now sought to be recovered was not involved in the earlier action.

A further and very material fact, which did not exist at the time of the earlier decision, but which did exist when this action was tried, was that this Court had decided adversely to several of the corporation's competitors in three cases involving the identical principle with respect to which the corporation was successful in its previous action. When the decisions of this Court were rendered in the *Armature Exchange*, *J. Leslie Morris Co.* and *Moroloy Bearing Service* cases, *supra*, the law was established for the first time within this Circuit. *Mercantile Nat. Bank v. Lander*, 109 Fed 21, 24 (C.C. N.D. Ohio). This new and additional fact was before the trial court in the present case. (R. 82-83.) The latter fact in and of itself should be sufficient to preclude the operation of the doctrines of *res judicata*, assuming it otherwise

would be applicable. See *Blair v. Commissioner*, 300 U.S. 5, wherein it was held that the rule of *Tait v. Western Maryland Ry. Co.*, 289 U. S. 620, was not applicable where, after the decision in the first proceeding, a decree of a state court as to the validity of an assignment created a new situation.

Yet, taxpayers have asked the court in the present proceeding to close its eyes to the facts before it and to give them a judgment which the court would not give to any other taxpayer whose cause of action had equal merit. The court is asked in actual effect to sanction a discrimination between these taxpayers and all other taxpayers merely because this corporation had previously obtained an earlier District Court decision which involved the application of the tax over a different period of time and which now admittedly appears to have been erroneous. The application of the doctrine of *res judicata* in such circumstances would serve no other purpose than to perpetuate a past error.

The doctrine of *res judicata* should not be so extended. As applied to excise taxes, as distinguished from income taxes, where different taxable periods are involved in two cases, the doctrine, if applied at all, should be applied narrowly. Not only should it

be confined to issues which are identical in the two cases, but the word "identical" should be rigidly construed. Otherwise, there would result discrimination against all other persons similarly situated, as members of the same industry, affected by the particular excise tax provisions. Such discrimination clearly would be contrary to public policy. Moreover, with the upward trend of the tax rate — it is now five per cent of the sales price — situations might easily be supposed in which the discrimination might spell the difference between the ability of the competing corporation, subject to the tax, to remain in business at a small profit on the one hand or financial ruin on the other.

We believe that the reasoning of the Supreme Court in *United States v. Stone & Downer Co.*, 274 U. S. 225, which sanctions a limited application of the doctrine to customs cases, should be followed here because similar considerations are present in the administration of the manufacturers' excise tax law. In the latter case, the Court sustained the Court of Customs Appeals which held that a previous decision construing the tariff statute and classifying merchandise thereunder was not *res judicata* in respect of a subsequent importation involving the same issue of fact and the same question of law. The Court said

(pp. 235-237) :

We think that, not only was it within the power of the Court of Customs Appeals to establish the practice, but that it was wise to do so. The effect of adjudicated controversies arising over classification of importations may well be distinguished from the irrevocable effect of ordinary tax litigation tried in the regular courts. There of course should be an end of litigation as well in customs matters as in other tax cases; but circumstances justify limiting the finality of the conclusion in customs controversies to the identical importation. The business of importing is carried on by large houses between whom and the Government there are innumerable transactions, as here for instance in the enormous importations of wool, and there are constant differences as to proper classifications of similar importations. The evidence which may be presented in one case may be much varied in the next. The importance of a classification and its far-reaching effect may not have been fully understood or clearly known when the first litigation was carried through. One large importing house may secure a judgment in its favor from the Customs Court on a question of fact as to the merchandise of a particular importation, or a question of construction in the classifying statute. If that house can rely upon a conclusion in early litigation as one which is to remain final as to it, and not to be reheard in any way, while a similar importation made by another importing house may be tried and heard and a different conclusion reached, a most embarrassing situation is presented. The importing house which has, by the principle of the thing adjudged, obtained a favorable decision permanently binding on the Government will be able to import the goods at a much better rate than that enjoyed by other importing houses, its com-

petitors. Such a result would lead to inequality in the administration of the customs law, to discrimination and to great injustice and confusion. In the same way, if the first decision were against a large importing house, and its competitors instituted subsequent litigation on the same issues, with new evidence or without it, and succeeded in securing a different conclusion, the first litigant, bound by the judgment against it in favor of the Government, must permanently do business in importations of the same merchandise at great and inequitable disadvantage with its competitors.

These were doubtless the reasons which actuated the Court of Customs Appeals when the question was first presented to it to hold that the general principle of *res judicata* should have only limited application to its judgments. These are the reasons, too, why the principle laid down by this Court in the decision already referred to, in *New Orleans v. Citizens' Bank*, 167 U.S. 371, should not apply or control.

The reasoning of the Supreme Court in the preceding case fits precisely the circumstances involved here.

We have learned, in handling these excise tax cases, that thousands of persons and firms have been similarly engaged in the production and sale of automobile parts comprised of a combination of new and used materials. Approximately one-half of all automotive replacement parts sold have been so comprised. The other half has been made up entirely of new ma-

terials. Both groups of manufacturers have been members of the automotive replacement parts industry and compete with each other. All of these taxpayers, being similarly situated, are entitled to equal treatment under the law. The successful invocation of the doctrine of *res judicata* by a few of these taxpayers would not serve to effect equality or uniformity of treatment before the law or by the courts.

So considered the wisdom of the Supreme Court's reasoning in the *Stone & Downer* case *supra*, is emphasized. It is immaterial that no rule respecting manufacturers' excise taxes yet has been promulgated similar to that long ago adopted in the Customs Court. Until recently, the need for such a rule had seldom been apparent but, with higher tax rates, it has become very important.

The Court of Claims in *Engineers Club of Phila. v. United States*, 42 F. Supp. 182, 187, recently passed upon a substantially similar situation in a suit for the refund of taxes on dues and initiation fees. It appeared that for a period preceding that before the Court of Claims, the taxpayer had obtained two decisions in its favor from the District Court for the Eastern District of Pennsylvania. One of the previous actions was against the Collector of Internal Revenue and the other against the United States and

it was held in both that plaintiff was not a social club and was entitled to recover the taxes paid on club dues and initiation fees for the period January 1932 to June 1935. The period involved before the Court of Claims was July, 1935 to January, 1938. The taxpayer contended that the decisions of the District Court in its favor holding that it was not a social club with respect to the earlier period was *res judicata* of the question for the succeeding period. In rejecting the applicability of the doctrine the Court of Claims stated (p. 187):

Plaintiff's activities in the latter period, here in question, were not those of the earlier period, previously litigated. They were comparable and similar. We have found that they were substantially the same in nature and extent. But they were a completely different set of events, and they were not the set of events litigated in the earlier cases. We are asked, then, to close our eyes and minds to the facts actually before us, and to give to plaintiff a judgment which we would not give to any other plaintiff whose cause of action had equal merit. We are asked thus to discriminate with regard to a public and recurring duty, the duty to pay taxes, thus setting plaintiff apart from all other taxpayers who resort to this court with similar cases.

The doctrine of *res judicata* should not be so extended. Any application of the doctrine in tax cases to relieve a taxpayer of, or to subject him to the payment of, a tax in a later year because of litigation with reference to an earlier year, has been criticized. A learned commentator has point-

ed out that the invocation of the doctrine in tax cases has promoted litigation instead of producing peace, as the doctrine is supposed to do.³ The instant case is an example. In addition to trying the facts of plaintiff's operations for the three years here in question, it has been necessary to try again the facts which were tried before the District Court covering another period of years, in order to determine whether they were so substantially similar that the doctrine of *res judicata* would have to be considered. The learned authority cited above suggests the following approach to the question: "Where different taxable years are involved in the two cases, *res judicata* should be applied much more narrowly than has been true in some cases in the past. Not only should it be confined to issues which are identical in the two cases, but the word 'identical' should be rigidly construed to apply only to situations where the applicable statute is unchanged and all of the controlling events occurred before the earlier of the tax years."⁴

The Supreme Court denied certiorari in this case on June 1, 1942.

Similarly, in *Duquesne Club v. Bell*, 42 F. Supp. 123 (W.D. Pa.), involving a suit for the refund of taxes paid with respect to club dues and initiation fees, the court held that a previous decision by the Court of Claims (23 F. Supp. 781), holding the Club

³ Griswold, *Res Judicata in Tax Cases*, 46 Yale L.J. 1320 (1937).

⁴ Griswold, *op. cit.* at p 1357.

to be a "social club" and taxable, was not *res judicata* with respect to whether it was a "social club" during a later period. Although the District Court was reversed (127 F. (2d) 363 (C.C.A. 3d), certiorari denied, October 12, 1942), such reversal did not involve the court's ruling with respect to *res judicata*.

We recognize that there are a substantial number of cases holding that a question of fact determined in a previous suit involved in an earlier tax year is *res judicata* in a subsequent suit for a later tax year. However, they are not excise tax cases and they do not involve the interpretation of a general taxing provision. In virtually all of them the question was one which in its very nature was unchanging and unchangeable — for instance, the right to take a deduction from gross income for amortization of bond discount on sales of particular bond issues (*Tait v. Western Maryland Ry. Co.*, *supra*); the value of timber on a specific date (*Donald v. J. J. White Lumber Co.*, 68 F. (2d) 441 (C.C.A. 5th)); the amount of earnings of a corporation over a particular period (*James v Commissioner*, 31 B.T.A. 712). The doctrine has also been applied to mixed questions of law and fact but there too the conclusion related to a matter inherently the same in each year, *e.g.*, whether certain transactions constituted a gift of stock from husband to wife

(*Marshall v. Commissioner*, 29 B.T.A. 1075), and whether contracts had a value on a particular date (*Worm v. Harrison*, 98 F. (2d) 977 (C.C.A. 7th)). Even in cases involving questions almost exclusively conclusions of law, the rule applied if the facts on which the conclusions rested were fixed, *e.g.*, the determination of the construction and legal effect of a will (*Haller v. Commissioner*, 26 B.T.A. 395, affirmed, 68 F. (2d) 780 (App. D.C.)).

On the other hand, the rule of *res judicata* has been held inapplicable in cases where the facts may change from year to year, *e.g.*, determination of whether a corporation was "doing business" (*Phillips v. International Salt Co.*, 274 U.S. 718; or whether a corporation's activities were "charitable" (*Peck v. Commissioner*, 34 B.T.A. 402); or, whether a group of corporations was "affiliated" in the respective tax year (*J. M. Smucker Co. v. Keystone Stores Corp.*, 12 F. Supp. 286 (W.D. Pa.), affirmed *sub nom. Franklin v. United States*, 83 F. (2d) 1010 (C.C.A. 3d)). Even a case involving the rate of depreciation of certain machinery has been held to be free from application of the rule on the ground that it necessarily involved a continuing judgment as to the depreciation rate, which judgment might properly and honestly vary from year to year. *Tait v. Commissioner*, 78 F. (2d)

193 (C.C.A. 3d).

In the light of the foregoing discussion and decisions, including the three intervening decisions of this Court and the long line of decisions of other federal courts throughout the United States, cited in Argument I, *supra*, we submit that the determination that the taxpayer corporation was not the manufacturer or producer of the connecting rods it sold during a different period from that here involved is not *res judicata* on the question of whether it was the manufacturer or producer of the articles it sold during the periods now in question. The District Court erred in reaching a contrary conclusion. By the same token, it erred in admitting in evidence, over the objection of the Government, the records of the prior action (R. 112), and in making its findings respecting that action, Nos. VI through IX (R. 56-59), and its conclusions, Nos. II through V (R. 60-61).

III.

TAXPAYERS HAVE FAILED TO ESTABLISH
THAT THEIR CORPORATION BORE THE
BURDEN OF THE TAX AND DID NOT PASS
IT ON

Finally, even if we should assume that the corporation was not a "manufacturer" subject to the tax,

taxpayers have failed to meet the burden of proving that the taxes were borne exclusively by the corporation and not passed on to its vendees or purchasers. The only evidence offered on this score was the following:

Appellee Seward testified, over objection of Government counsel, that no tax was added in the bill or on the invoice. (R. 107.) This was clearly a conclusion of the witness, unsupported by any records or proffer thereof. It was not the best evidence, and was incompetent. On cross examination, the witness stated that they arrived at the invoice price by taking prices of some of the locally advertised connecting rods; others, they just made — took them from the general market. (R. 107.) They did not bill any additional tax as a separate item. (R. 107.) They used prices of Federal-Mogul and a concern in San Francisco. (R. 108.)

The witness Taylor identified himself as a public accountant, auditor for Con-Rod Exchange, Inc., since 1924, and as being familiar with the corporation's method of billing during the period 1934 to 1936. (R. 109.) He was permitted to testify, over objection by Government counsel, that the retained copies of duplicates of bills did not show the tax added. (R. 110-111.)

The only other testimony thereon was adduced on direct examination of the witness Evans, who had been connected with the Excise Division of the Collector's office and had had something to do with auditing the accounts of Con-Rod Exchange for manufacturers' tax purposes several years before. (R. 91-92.) He testified (R. 95):

Q. Did you find, in any case, that they billed any customer with any amount as tax on the sales?

A. I don't remember; on the other hand, it seems to me I do remember they had records with tax being on, some of those invoices.

Q. But you don't remember?

A. No, I wouldn't want to go on record.

Q. Did you make any report whether they had passed the tax on or not?

A. No, I didn't.

We have challenged the court's ruling with respect to the foregoing objections. (R. 139, Point X.)

The above evidence clearly would not have justified a determination by the Commissioner of Internal Revenue that the taxpayer corporation had met the requirements of Section 621(d) of the Revenue Act of 1932 (Appendix, *infra*). One of the reasons assigned by the Commissioner in his letters rejecting the refund claims was the apparent failure to estab-

lish that the tax was not passed on to the customers but was borne by the taxpayer corporation. (R. 40.) Consequently, the court's findings No. X (R. 59) — a prerequisite to any recovery — that the corporation did not include the tax in the price of the articles sold, but itself bore the burden thereof, is clearly without any competent supporting evidence and therefore erroneous. *Jergens Co. v. Conner*, 125 F. (2d) 686 (C.C.A. 6th); *Piver, Inc. v. Hoey*, 101 F. (2d) 68 (C.C.A. 2d), and *Luzier's, Inc. v. Nee*, 106 F. (2d) 130 (C.C.A. 8th).

CONCLUSION

The judgment of the District Court should be reversed

Respectfully submitted,

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APPENDIX

Revenue Act of 1932, c. 209 47 Stat. 169:

SEC. 606. TAX ON AUTOMOBILES, ETC.

There is hereby imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

* * *

(c) Parts or accessories (other than tires and inner tubes) for any of the articles enumerated in subsection (a) or (b), 2 per centum. * * * *

[Note: Subsections (a) and (b) refer to automobiles, automobile trucks and motor cycles.]

SEC. 621. CREDITS AND REFUNDS.

* * *

(d) No overpayment of tax under this title shall be credited or refunded (otherwise than under subsection (a)), in pursuance of a court decision or otherwise, unless the person who paid the tax establishes, in accordance with the approval of the Secretary, (1) that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee, or (2) that he has repaid the amount of the tax to the ultimate purchaser of the article, or unless he files with the Commissioner written consent of such ultimate purchaser to the allowance of the credit or refund.

[Note: Sec. 3443 (d) of the Internal Revenue Code, approved February 10, 1939, is to the same effect.]

Treasury Regulations 46, approved June 18, 1932:

ART. 4. *Who is a manufacturer or producer.*
—As used in the Act, the term “producer” includes a person who produces a taxable article by processing, manipulating, or changing the form of an article, or produces a taxable article by combining or assembling two or more articles.

* * *

ART. 41. *Definition of parts or accessories.*
—The term “parts or accessories” for an automobile truck or other automobile chassis or body, or motorcycle, include (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, or (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

* * *

ART. 71. *Credits and refunds.*—

* * *

If any person overpays the tax due with one monthly return, he may either file a claim for refund on Form 843 or take credit for the overpayment against the tax due with any subsequent monthly return. In all cases (except those referred to in section 621 (a), discussed under the preceding paragraphs of this article) where a person overpays tax, no credit or refund shall be allowed, whether in pursuance of a court decision

or otherwise, unless the taxpayer files a sworn statement explaining satisfactorily the reason for claiming the credit or refund and establishing (1) that he has not included the tax in the price of the article with respect to which it was imposed, or collected the amount of tax from the vendee, or (2) that he has either repaid the amount of the tax to the ultimate purchaser of the article or has secured the written consent of such ultimate purchaser to the allowance of the credit or refund. In the latter case the written consent of the ultimate purchaser must accompany the sworn statement filed with the credit or refund claim. The statement supporting the credit or refund claim must also show whether any previous claim for credit or refund covering the amount involved, or any part thereof, has been filed with the Collector or Commissioner.

A complete and detailed record of all overpayments must be kept by the taxpayer for a period of at least four years from the date a credit is taken or refund claimed.

Treasury Regulations 46, approved January 8, 1940:

SEC. 316.4 *Who is a manufacturer.* — The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

* * *

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vs.

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EXCHANGE, INC., a Corporation,
 Appellees.

UPON APPEAL FROM THE DISTRICT COURT OF THE
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OF WASHINGTON, SOUTHERN DIVISION
HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLEES

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IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

THOR W. HENRICKSON, Acting Collector
of Internal Revenue,

Appellant,

vs.

RICHARD E. SEWARD and HELEN ROBERTS, Liquidating Trustees of CON-ROD EXCHANGE, INC., a Corporation,

Appellees.

No. 10235

UPON APPEAL FROM THE DISTRICT COURT OF THE
UNITED STATES FOR THE WESTERN DISTRICT
OF WASHINGTON, SOUTHERN DIVISION
HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR APPELLEES

STATEMENT

The transcript of proceedings before the court (R. 71 to 135) is disjointed and confusing, and most of it has no relation to the matters involved in this appeal.

As the case stood when it came on for trial, two general questions were presented: The first, whether the question of liability for the manufacturers sales tax had been adjudicated between the parties by pre-

vious decision in the controversy between them involving the period from October 1, 1935, to October 1, 1936; and, second, whether the operations for the period in question in this case, namely from 1932 to 1935, upon which the assessment was based, covered transactions that were purely repair and admittedly non-taxable, and should therefore be eliminated. More specifically, with respect to the latter point, the question was whether the agent, in setting up the tax, had included instances where the customer brought in his own connecting rods, had them repaired, and specifically returned to him, which is admittedly not subject to the tax, along with transactions where the customer exchanged his own worn out connecting rods for others which taxpayer had repaired. Most of the statement, argument and evidence included in the statement of facts concerned this latter point, and the possibility of reaching an understanding on it which would avoid the necessity of going into thousands of transactions occurring over the period of three or four years involved. This question was further complicated by the fact that there were no records available to the investigating agents for the period between 1932 and 1933 and they simply assumed a course and volume of business to have existed in those years comparable to the showing made by the records for the years 1934 and 1935. Before the conclusion of the hearing, after conference, the parties reached an agreement under which plaintiff abandoned any attempt to establish that any part of the assessment related to pure repairs as distinguished from exchanges (R. 129). It did, however, establish

that the tax for 1932 and 1933 was set up on an arbitrary or estimated basis without supporting records, determined with relation to the volume shown by the records for 1934 and 1935, under which, for the year 1932 there was assessed a tax of \$300.31, a penalty of \$50.09 and interest of \$67.47; and for 1933 there was assessed a tax of \$379.56, a penalty of \$94.90 and interest of \$92.99 (R. 129, 131).

On the other point of *res judicata*, upon which the court decided in taxpayer's favor, the evidence is very brief and may be stated simply as follows:

The assessment for the period in question in this case covers nothing but repairs and exchanges of connecting rods (R. 94, 95). With respect to these, there was no difference in the method of treatment, or handling, or the physical operations involved, during the period here in question, from the period covered by the proceeding before Judge Yankwich (R. 89, 93, 106). Appellant's counsel conceded "that the facts with respect to the actual manufactory, or repair, whichever you wish to call it, as set forth in Judge Yankwich's opinion, pertain to this period; I mean, the actual manufacture" (R. 106). The trial court found that the operations were identical in both periods (R. 57).

On the question of whether the tax was passed on to the customer, it was appreciated that of course the previous decision for one period would not be *res judicata* as to the other period and testimony on that point was offered (R. 107, 108, 111), from which the court found as a matter of fact that the tax was not added and passed on (R. 133, 134, 59).

ARGUMENT

In support of his appeal the appellant submits three contentions:

1. That the repair and exchange of connecting rods constituted a transaction subject to the manufacturers excise tax.

2. That the decision of Judge Yankwich in *Con Rod Exchange, Inc., v. Henricksen*, 28 F. Supp. 924, should not be considered as *res judicata* upon the question of whether such operations were subject to the tax as between these parties (R. 20, 32).

3. That Section 621 of the Revenue Act of 1932, prohibiting a refund unless taxpayer establishes that the tax has not been passed on, was not complied with.

Liability to Tax

The appellees will make no contention that the decision in the first case was legally correct, although in fairness to the Judge who decided that case, it should be recognized that there was then ample legal authority for the view which he took. That question, however, is no longer open to argument in view of the subsequent decisions of this court in *U. S. v. Armature Exchange*, 116 F.(2d) 969; *U. S. v. J. Leslie Morris Co.*, 124 F.(2d) 371; *U. S. v. Moroloy Bearing Service*, 124 F.(2d) 373, and therefore there is no occasion to consider or discuss the numerous foreign or federal cases cited or the legislative history of the Act as presented in the appellant's brief.

Passing On of Tax

As to the third point concerning the passing on of the tax, the appellees recognize that this is a condi-

tion or prerequisite to refund that must be met independently of the substantive right to recovery and may be subject to variation with each separate transaction. They agree that the doctrine of *res judicata* has no application to that particular question and to meet the requirement of the statute they offered positive evidence that the tax was not passed on to the purchaser.

The testimony showed that there was no change made in the price by reason of the tax and that in fact the taxpayer did not know anything about the tax on such transactions until long after they occurred. This was a question of fact (*Appeal of Arden-Rayshine Co.*, 43 B.T.A. 314 at 318) upon which the court made a definite finding in appellees' favor (R. 59, 133, 134). There was substantial evidence to support this finding (R. 106, 111). No evidence was offered to the contrary. The finding is conclusive and not subject to review upon this appeal. *U. S. v. Jefferson Elec. Mfg. Co.*, 291 U.S. 386 at 407, 78 L. ed. 860 at 874; *Luzier's Inc. v. Nee* (C.C.A. 8) 106 F.(2d) 130, 39-2 U.S.T.C. §9657.

However, as a matter of interest in considering what showing of negative fact has been held sufficient in similar cases, see the following:

Ney v. U.S. (D.C. Va.) 33 F. Supp. 554. The fact that taxpayer continued to sell merchandise at the same prices charged before the tax was imposed was considered substantial evidence that it was not passed on.

Bullock's, Inc., v. U. S. (D.C.S.D. Cal.) 43 F. Supp. 861, 42-1 U.S.T.C. §9303. The fact that prices were fixed by managers or department heads who had no

information about the tax and testified that no increase in price was made because of it was considered substantial evidence that the tax was not passed on.

Poindexter and Sons v. U.S. (D.C. Mo.) 40 F. Supp. 787, 41-2 U.S.T.C. §9678.

Appeal of *Sophie Jaski*, 43 B.T.A. 321, holding that sale of the products at the same price after as before the tax went into effect established that they were not passed on.

Res Judicata

While the appellant makes a faint argument that the doctrine of *res judicata* is not applicable because this case did not involve exactly the same transactions embraced in the earlier suit, he concedes that they were comparable and similar. Appellant's counsel admitted at the trial that the physical operations of manufacturing or repairing were the same in the transactions involved in this case as found by the court in the earlier case (R. 106, See also R. 89, 93) and the court made a finding that the physical processes "were identical in their nature in this action and in the preceding suit" (R. 57).

Appellant does not seriously contend that the doctrine of *res judicata* is not well established by the federal decisions in tax cases, but seeks to avoid its application for two reasons:

1. It is contended that the later decisions holding such operations to constitute manufacture interject an additional fact requiring an exception under the doctrine of *Blair v. Commissioner*, 300 U.S. 5, 37-1 U.S.T.C. §9083. But in that case the court was dealing with a situation which required it to accept state

law as a controlling factor upon its decision, which state law had been changed between the time of the first and second cases. The court, with respect to that point said, "Here, after the decision in the first proceeding, the opinion and decree of the state court created a new situation. The determination of petitioner's liability for the year 1923 had been rested entirely upon the local law. *Comm. v. Blair*, 60 F.(2d) 340, 342, 344. The supervening decision of the state court interpreting that law in direct relation to this trust can not justly be ignored in the present proceeding so far as it is found that the law is determinative of any material point in controversy."

That decision obviously rests upon treating the controlling state law as a fact which was not identical but different in the two proceedings.

2. Secondly, it is claimed that an exception ought to be made and a different rule followed in an excise tax case on the basis of a restriction of the doctrine of *res judicata* with reference to decisions of the Court of Customs Appeals, as announced in *U. S. v. Stone & Downer Co.*, 274 U.S. 225, 71 L. ed. 1013. That case, however, must be restricted to its peculiar facts. It did not involve application of *res judicata* as established by the decisions of the Federal Court as a matter of general law but turned upon whether the Court of Customs Appeals, as a limited and special tribunal, was justified in adopting a different rule. The court pointed out that by the act creating that tribunal "the whole question of classification and refunding of duties was taken out of the jurisdiction of the regular federal judiciary. The classification by the Court

of Customs Appeals was made final, and no appeal was granted to this court," 274 U.S. at 232. Then after pointing out that it was not until the Act of August 22, 1914, that a limited review was given to the Supreme Court and that during the interim the Customs Court of Appeals was final and conclusive, both as to the law, the fact and its rules of conduct, it said,

"It was thus for five years put in a position where it must not only make its own rules but it must determine, as a practical matter, what should be the conclusive effect of its own judgments in the determination of questions of fact and statutory construction and classification in subsequent cases brought before them by the same parties and presenting similar issues. In the exercise of this jurisdiction, it established the practice that the finding of fact and the construction of the statute and classification thereunder as against an importer was not *res judicata* in respect of a subsequent importation involving the same issue of fact and the same question of law." 274 U.S. 233, 234.

* * * * *

"There would seem to be an analogy between the proper respect of this court for the conclusion of the court of customs appeals upon the question of the estoppel of its own decisions when it was an independent court not subject to review by this court, and our respect for judgments of the state courts in limiting the application of the estoppel of their decisions in tax cases, and unless some controlling reason exists why we should overrule the established practice in this matter of the court of customs appeals, now that the power of review of some of its judgments has been given us, we should follow it." 274 U.S. 235.

The application of this case and the portion quoted by appellant at page 21 of his brief is therefore limited and controlled as set forth above, making it applicable only to that special situation. That it has no proper relation to the general application of *res judicata* to tax cases in the Federal Court is recognized by this court in *Lee Co. v. U.S.* 41 F.(2d) 460, in which, after approving the general doctrine of *res judicata*, it is said:

“By appellee reliance is had on *United States v. Stone & Downer Co.*, 274 U.S. 225, 47 S.Ct. 616, 71 L. ed. 1013. But the court was there reviewing a judgment of the Court of Customs Appeals exercising jurisdiction in a special field of litigation quasi administrative, and it was accordingly held not only that the Customs Court was within the exercise of the power conferred upon it by Congress in declining, because of the distinctive character of the controversies coming before it, to recognize the rule of *res adjudicata*, but that such recognition would be unwise. We find little analogy between that case and this, and in it no warrant for extending, to a familiar class of litigation, a ruling limited in its reasoning to a new and distinctive field.”

While it is suggested that the reason supporting the rule of the Court of Customs Appeals in customs cases ought to be applied to excise tax cases, because the taxpayer who is benefited by the doctrine may obtain some advantage over his competitors, we see nothing peculiar to the excise tax law in that situation. The advantage of such a taxpayer is no different in kind from the advantage enjoyed by reason of application of the doctrine in *New Orleans v. Citi-*

zens' Bank, 167 U.S. 371, 12 S. Ct. 905, 42 L. ed. 202, which we shall discuss at greater length hereafter; nor from the situation existing in *Lee Co. v. Federal Trade Comm.* (C.C.A. 8) 113 F.(2d) 583, where the doctrine of *res judicata* was applied to prevent successive condemnations under the Food and Drug Act.

Numerous cases are cited by the appellant which do not question the doctrine or its general application to tax cases, but hold it inapplicable because of a change or lack of identity in the facts (Appellant's brief, pages 23, 25, 27). Such are the cases involving the question of whether the activities of a club are social in character from year to year, of which the decision of the Court of Claims in *Engineers Club of Phila. v. U.S.*, 42 F. Supp. 182, 187, 42-1 T.C. §9255, is an extreme example. But in that case the court pointed out as the basis for its decision that "the facts were, as we have said, not identical. They were a different, though similar, set of events. They consisted of a whole course of conduct from day to day in all its detail of an enterprise of considerable scope. They were the kind of events which, though similar, might easily vary from period to period enough to change the judgment of the same tribunal though it held the same view of the meaning of the applicable statute." Judge Whitaker, concurring specially, expressed the opinion that *res judicata* was applicable under the decisions of the Supreme Court but thought that the plaintiff could not recover for other reasons. While the Supreme Court denied certiorari, its decision may well have been predicated on these other grounds.

We see no necessity for further discussion of these

cases, involving different or varying sets of facts, in view of the evidence and findings in this case that the facts with respect to manufacture affecting the statutory liability were identical with those in the earlier proceeding (R. 57).

3. Whatever may be the criticisms or objections to the doctrine of *res judicata* it is well established as a principle of Federal Law applicable to tax cases.

The general principle is stated in 2 Freeman, Judgments (5th ed. 1925) Sec. 627, 1322, as follows:

“An existing final judgment or decree rendered upon the merits by a court of competent jurisdiction upon a matter within its jurisdiction is conclusive of the rights of the parties or their privies in all other actions in the same or any other judicial tribunal of concurrent jurisdiction, on the points and matters in issue and adjudicated in the first suit.”

A leading case on *res judicata* in tax suits is *New Orleans v. Citizens' Bank* (1897) 167 U.S. 371, 12 S. Ct. 905, 42 L. ed. 202. In that case an assessment sought to be made upon the stock of a bank was challenged upon the ground that the bank's charter rendered its stock exempt from taxation. This contention based upon the same charter had been sustained in a suit involving taxes assessed for a previous year. The Supreme Court of the United States held that the prior determination was conclusive of the invalidity of the later assessment. Involving as it did the assessment of a tax for a different period from that with respect to which the prior judgment had been entered, this case thus dealt squarely with the question of the effect of the principle of *res adjudicata* upon a claim

different from that existing in a prior action. All courts are agreed that a judgment in a tax suit is binding on the parties with respect to that particular assessment or liability and appellant herein raises no question as to the validity of this principle.

The decision, however, in *New Orleans v. Citizens' Bank*, *supra*, goes farther than to recite this general rule, and the extension of the general principle to application to the present case is established by the language of the court in the *Citizens' Bank* case at page 396:

“The proposition that because a suit for a tax of one year is a different demand from the suit for a tax of another, therefore *res judicata* cannot apply, whilst admitting in form the principle of the things adjudged, in reality substantially denies and destroys it. The estoppel resulting from the thing adjudged does not depend upon whether there is the same demand in both cases, but exists, even although there be different demands, when the question upon which the recovery of the second demand depends has under identical circumstances and conditions been previously concluded by a judgment between the parties or their privies * * *.”

The court in the *Citizens' Bank* case in setting forth the rule and its limitations, also quoted from the case of *Cromwell v. Sac County*, 94 U.S. 353, 24 L. ed. 198:

“‘But where the second action between the same parties is upon a different claim or demand, the judgment in the prior action operates as an estoppel only as to those matters in issue or points controverted upon the determination of which the finding or verdict was rendered. In all cases,

therefore, where it is sought to apply the estoppel of the judgment rendered upon one cause of action to the matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated or determined in the original action, not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action.' ”

Further substance in support of the contention that *res judicata* must apply in the proceedings at bar is to be found in the opinion in the *Citizens' Bank* case, *supra*, at page 398.

“It follows, then, that the mere fact that the demand in this case is for a tax for one year, and the demands in the adjudged cases were for taxes for other years, does not prevent the operation of the thing adjudged, if in the prior cases the question of exemption was necessarily presented and determined upon identically the same facts upon which the right of exemption is now claimed.

“The argument that as a matter of public policy the principle of the thing adjudged should be held not to apply to controversies as to taxation, if there be merit in it, should be addressed to the law-making and not to the judicial departments.”

Reference should also be made to this opinion at page 401 in which Mr. Justice White quotes as follows from the case of *Goodnow v. Litchfield*, 59 Iowa 226:

“ ‘It is undoubtedly true that the taxes of each year ordinarily constitute separate and distinct rights or causes of action. But where an action is brought to recover taxes paid in one year, and an action is afterwards brought to recover for

the taxes paid in a subsequent year, and the adjudication in the first is pleaded as a bar to the recovery in the second action, the question whether the estoppel is effectual will depend upon the issues in the two actions. If the right to recover and the defense thereto are based upon precisely the same grounds, why litigate again the question that has been determined? In such case the very right of the matter has been determined by a court of competent jurisdiction. It is not essential the causes of action should be the same but it is essential the right or title should be; that is the issue in both actions and the matter on which the estoppel depends must be the same, or substantially so. * * * ’’

The application of the rule of *res judicata* to cases involving different causes of action is so well established as to not require extensive citation of authority in support of it. Brief reference, however, will here be made to several of the other leading cases supporting this rule. Thus, in *Southern Pacific Railroad Company v. United States* (1897) 168 U.S. 1, 18 S. Ct. 18, 42 L. ed. 355, the court at page 48 stated the rule that:

“The general principle announced in numerous cases is that a right, question, or fact distinctly put in issue and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; and even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established, so long as the judgment in the first suit remains

unmodified. This general rule is demanded by the very object for which civil courts have been established, which is to secure the peace and repose of society by the settlement of matters capable of judicial determination. Its enforcement is essential to the maintenance of social order; for, the aid of judicial tribunals would not be invoked for the vindication of rights of person and property, if, as between parties and their privies, conclusiveness did not attend the judgments of such tribunals in respect of all matters properly put in issue and actually determined by them."

See to the same effect *Oklahoma v. Texas* (1921) 256 U.S. 70, 41 S. Ct. 420, 65 L. ed. 831; 2 Freeman, Judgments (5th ed. 1925) Section 627.

The rule as stated in the *Citizens' Bank* case and other authorities cited, *supra*, has without question been applied to cases arising under the income and estate tax laws. The leading case holding to this effect is *Tait v. Western Maryland Railway Company* (1932) 289 U. S. 620, 53 S. Ct. 706, 77 L. ed. 1405, which should be decisive of the question involved in the proceedings at bar. In that case the original proceedings involved the question of the validity of the Commissioner's refusal to allow as a deduction from gross income for the taxable years 1918 and 1919 of the plaintiff an amortized proportion of the discount on the sale of bonds by two companies, of which the plaintiff was the successor. On appeal from a decision of the Board of Tax Appeals, judgment was entered for the plaintiff taxpayer. During the period from 1920 through 1925 deductions for amortization of the bond discount in question were either not taken or not

allowed, and for each year suit was brought against the collector for refund. The cases were consolidated in the District Court, which found no facts to have been presented which had not been before the Board of Tax Appeals in respect to the 1918 and 1919 taxes and that the parties were concluded by the former decision. This judgment was affirmed in the Circuit Court of Appeals and an appeal was taken therefrom by the Collector to the Supreme Court. The Collector maintained that a judgment in a suit concerning income tax for a given year could not estop either party in a later action touching liability for taxes of another year, and, in the alternative, that he was not precluded by the former judgment because neither the proof nor the parties were the same as in the prior proceeding. As to the first contention, the court stated in 289 U.S. 620 at page 624:

“As petitioner (Collector) says, the scheme of the Revenue Acts is an imposition of tax for annual periods, and the exaction for one year is distinct from that for any other. But it does not follow that Congress in adopting this system meant to deprive the government and the taxpayer of relief from redundant litigation of the identical question of the statute’s application to the taxpayer’s status.

“This court has repeatedly applied the doctrine of *res judicata* in actions concerning State taxes * * *. It cannot be supposed that Congress was oblivious of the scope of the doctrine and in the absence of a clear declaration of such purpose, we will not infer from the annual nature of the exaction an intent to abolish the rule in this class of cases.

"We are not persuaded that the operation of the principle of the thing adjudged in tax cases will, as petitioner insists, produce serious inequalities or result in great confusion; but any adverse consequence in the administration of the law furnishes no sufficient reason for the abandonment of a rule founded in sound policy, to the enforcement of which suitors are in justice entitled."

Cases holding in accord with this decision and following its rule include:

Leininger v. Commissioner (C.C.A. 6, 1936)
86 F. (2d) 791;

Greenbaum v. U. S. (Ct. Cls. 1936) 17 F.
Supp. 83;

Pink, etc. v. U. S. F. Supp. (1938)
38-1 U.S.T.C. Par. 9084, rev'd on other
grounds (C.C.A. 2, 1939) 105 F.(2d) 183;

*Pryor & Lockhart Development Co. v. Com-
missioner* (1936) 34 B.T.A. 687.

The Supreme Court in the *Western Maryland Railway* case regarded as of primary importance the question: Is the question or right here in issue the same as that adjudicated in the former action? The court, in answering its own question in the affirmative found (289 U.S. 625) that the pertinent language of the Revenue Act was identical; that the Regulations remained unchanged; and that the facts with respect to the sale of the bonds and the successive ownership of the railroad property were the same at the time of both trials and concluded that the right then con-

tested, arising out of the same facts appearing in this record, was adjudged in the prior proceedings.

Can it be said that the situation presented in the proceedings at bar is different from that in the *Western Maryland Railway Company* case? Appellees submit that it cannot. Here again no substantial change appeared in the applicable provisions of the Revenue Act or in the Regulations issued by the Treasury; and the facts here with respect to the transactions involving rebabbiting of connecting rods are identical in all the periods in question, including the period as to which judgment has already been rendered. That judgment determined that such transactions did not constitute manufacturing of automobile accessories within the meaning of the federal excise tax law. No distinction may be drawn between an adjudication on the one hand that certain bond discount is allowable and an adjudication on the other hand that a certain corporation's activities do not constitute taxable transactions, where it is shown that the transactions in no wise differed during the taxable periods in question except in respect to the time element.

In *North St. Louis Gymnastic Society v. Hagerman* (Mo. 1911) 135 S.W. 42, in which case the liability of the society turned upon the question whether it had used its property during the taxable year solely for "educational" purposes, the court held that the issue was *res judicata* since substantially similar use during a previous year had been adjudged "educational."

See to the same effect:

People ex rel. Harding v. Omega Chapter
(Ill. 1929) 167 N. E. 16;

Chicago M. & St. P. R. Co. v. Racine (Wis. 1904) 100 N. W. 1033;

Denver v. Colorado Seminary (Colo. 1934) 41 P. (2d) 1109.

Considerations, consisting of a general interest in the termination of disputes and the right of an individual to be protected from a vexatious multiplication of suits in which repeated adjudications of the same matter are sought, compelled the Court in the *Western Maryland Railway* case to apply *res judicata* to tax cases. They are just as strongly applicable to disputes between the government and an individual as they are to controversies between individuals and so the Court found in the *Western Maryland Railway* case. No less strongly do they apply in cases involving excise rather than income taxes; in fact, the necessity for protection from vexatious litigation would seem to be more pressing in the former case because of the fact that assessment and collection of the manufacturer's excise tax occurs with greater frequency and covers shorter periods than in the case of the income tax. Conceivably, it might be necessary for a taxpayer in the position of the appellees to secure, through Court proceedings, a refund of a tax illegally collected for one month, and subsequently be compelled to bring the same sort of proceedings the following month to recover the taxes paid during the latter period, were it not for the protection afforded by the rule upon which appellees herein rely. Where a different decision is later reached on a similar set of facts, the remedy for any inequality alleged to result from exemption of a particular taxpayer by rea-

son of the prior decision lies in amendment of the particular statute in question to accord with what has been found to be the sounder view. But as the Court has indicated in the *Western Maryland Railway* case, efforts to correct the situation on the part of the government should be directed to the legislative body and no alleged policy in that regard is so strong as to compel a Court to disregard its own prior adjudication.

Reference may be made to an interesting article in Paul's Selected Studies in Federal Taxation, 2nd series, at page 104, entitled "Res Judicata in Federal Taxation." But neither the progressive views of this author, nor of Professor Griswold, whose article similarly entitled, 46 Yale Law Journal, 1320, is relied upon by the appellant, go so far as to suggest that a distinction should be made between excise and other tax cases, or invite the application of the special rule adopted by the Court of Customs appeals. The argument against superior advantage to the taxpayer (appellant's brief p. 20) applies just as logically to the benefit resulting to the taxpayer in *New Orleans v. Citizens Bank*, 167 U.S. 371, 12 S. Ct. 905, 42 L. ed. 202, under which the bank enjoyed continuing exemptions from taxation of its stock, to the disadvantage of its competitors. Granting that inequalities do result in particular cases, the principle has been adopted and sustained on the basis of greater public benefit resulting from an end of litigation. If this is a situation which is thought undesirable, it should, and may at any time, be changed by legislation.

CONCLUSION

The doctrine of *res judicata* and its application to tax cases, as recognized in the foregoing authorities, is so well established that appellant has not seriously sought to question it but only to escape it on the ground of a difference in facts or that a special exception should be made as regards excise taxes. Since the factual situation is found to be identical, there is no basis for that distinction; nor is there any precedent or authority for making a special exemption or exception because of the nature of the tax, on the basis of the decision in the *Stone & Downer* case, in view of the limitations of the decision in that case and the reasons for its nonapplicability to this case pointed out in *U. S. v. Lee Co., supra*. Since appellant did not see fit to appeal from the earlier decision, it is binding between these parties in the disposition of this case.

Respectfully submitted,

JONES & BRONSON,

H. B. JONES,

Attorneys for Appellees.

No. 10245

United States
Circuit Court of Appeals
For the Ninth Circuit.

CHARLES CHAPLIN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

CHARLES CHAPLIN,

Respondent.

Transcript of the Record

Upon Petitions to Review a Decision of the
Tax Court of the United States

FILED

NOV - 6 1942

No. 10245

United States
Circuit Court of Appeals
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CHARLES CHAPLIN,

Petitioner,

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Upon Petitions to Review a Decision of the
Tax Court of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES:

For Taxpayer:

LOYD WRIGHT, ESQ.

HERSCHEL B. GREEN, ESQ.

J. R. WHITE, C. P. A.

For Comm'r:

FRANK T. HORNER, ESQ.

BYRON M. COON, ESQ.

Docket No. 98795

CHARLES CHAPLIN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1939

- May 26—Petition received and filed. Taxpayer notified. Fee paid.
- May 26—Copy of petition served on General Counsel.
- June 29—Answer filed by General Counsel.
- June 29—Request for Circuit hearing in Los Angeles filed by General Counsel.
- July 7—Notice issued placing proceeding on Los Angeles calendar. Answer and request served.

1940

March 6—Hearing set June 3, 1940, in Los Angeles, California.

June 3—Hearing had before Mr. Black on motion of petitioner to continue on the next calendar at Los Angeles, California, showing good cause. No objection by respondent. Motion to continue granted. Motion to continue filed at hearing. Copy served on both parties.

1940

Sept. 19—Hearing set Dec. 2, 1940. Los Angeles.

Mar. 22—Motion for continuance to next calendar at Los Angeles filed by taxpayer.

Mar. 22—Order restoring proceeding to the Los Angeles, California, calendar for hearing in due course entered.

Dec. 30—Hearing set Feb. 17, 1941, in Los Angeles, California.

1941

Feb. 26—Hearing had before Mr. Mellott on merits. Submitted. On motion of respondent amend answer. Granted. Petitioner given leave to reply. Stipulation of facts. Appearance of H. B. Green. Motion for leave to file amended answer, and amended answer filed. Petitioners brief due 4/28/41. Respondents 5/28/41. Reply 6/17/41.

Mar. 14—Transcript of hearing 2/26/41 filed.

Apr. 23—Brief and proposed findings of fact filed

1941

by taxpayer. 4/23/41 copy served on General Counsel.

May 28—Brief filed by General Counsel.

June 16—Reply brief filed by taxpayer. 6/16/41 copy served on General Counsel. [1*]

June 20—Motion to cite the decision of the United States Supreme Court in the Burnet case filed by General Counsel.

June 20—Motion to cite the decision of the United States Supreme Court in the Burnet case granted.

1942

Feb. 24—Findings of fact and opinion rendered. Mellott, Div. 11. Decision will be entered under Rule 550. 2/25/42 copy served.

Mar. 20—Computation of deficiency filed by General Counsel.

Mar. 23—Hearing set April 22, 1942, on settlement.

Apr. 4—Consent to settlement filed by taxpayer.

Apr. 6—Decision entered. Mellott, Div. 11.

June 8—Supersedeas bond in the amount of \$126,854.38 approved and ordered filed.

June 8—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

June 8—Proof of service filed by taxpayer.

June 23—Certified copy of an order from the 9th Circuit extending time to 9/18/42 to prepare and transmit the record filed.

*Page numbering appearing at top of page of original certified Transcript of Record.

1942

- July 1—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by General Counsel.
- July 9—Narrative statement of evidence filed by taxpayer, with proof of service thereon.
- July 9—Praecipe for record filed by taxpayer, with proof of service thereon.
- July 9—Notice of filing praecipe for record filed by taxpayer.
- July 11—Proof of service of filing petition for review filed by General Counsel (2).
- July 16—Stipulation extending the time to Aug. 5, 1942, to complete the record filed.
- Aug. 5—Agreed designation of portions of the record to be printed filed.
- Aug. 5—Agreed designation of portions of record, proceedings, and evidence to be contained in record on review filed.
- Aug. 5—Statement of points filed by General Counsel, with proof of service thereon.
- Aug. 6—Certified copy of order from the 9th Circuit re consolidation for briefing, hearing, argument and decision upon a single consolidated transcript of record to be certified and transmitted to this Court by the Clerk, U. S. Board of Tax Appeals, a certified copy of this order to be incorporated in the record filed.
- Aug. 6—Certified copy of order from the 9th Circuit, extending the time to 9/18/42 to complete the record filed. [2]

United States Board of Tax Appeals

Docket No. 98795

CHARLES CHAPLIN,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IT:LA:FHG-90D) dated March 2, 1939, and as a basis for his proceedings alleges as follows:

1. The petitioner is an individual with address at 1416 North La Brea Avenue, Los Angeles, California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A), was mailed to the petitioner on March 2, 1939.

3. The taxes in controversy are income taxes for the calendar year 1935. The deficiency asserted by the Commissioner is \$65,208.48, whereas the petitioner claims an overpayment of \$24,938.04 making a total of \$90,146.52 all of which is in controversy.

4. The determination of tax set forth in the notice of deficiency is based upon the following errors;

[3]

(a) In determining the taxable net income of the petitioner for 1935 the Commissioner erroneously included as income the amount of \$104,709 representing the fair market value of stock of United Artists Corporation released from escrow in 1935.

(b) In determining the taxable net income of the petitioner for 1935 the Commissioner erroneously included as ordinary income rather than as dividend income \$44,532.22 dividends on the escrowed stock also released from escrow in 1935.

(c) In computing the normal tax of petitioner for 1935 the Commissioner erroneously reduced the credit for dividends received by such \$44,532.22 dividends.

(d) Without prejudice to any of the above allegations of error it is further alleged that in determining the taxable net income of the petitioner for 1935 the Commissioner erroneously included as income \$44,532.22 dividends paid on the escrowed stock prior to 1935 and released to petitioner in 1935.

The facts upon which the petitioner relies as the basis for this proceeding are as follows:

(a) In 1919 petitioner and others caused United Artists Corporation to be formed and petitioner subscribed and paid for 1,000 shares of preferred and 1,000 shares of common stock of the corporation. Such shares were issued to the petitioner and recorded in his name.

(b) At the same time petitioner entered into an agreement with United Artists Corporation whereby he undertook to produce and deliver to the corporation a certain number of motion pictures which the corporation undertook to distribute.

(c) Under that agreement petitioner deposited his 1,000 shares of common stock of United Artists Corporation in escrow as guarantee of his performance of the agreement.

(d) From time to time shares of stock of United Artists Corporation were delivered to petitioner by the escrow agent pro rata as petitioner delivered pictures under the agreement or as the agreement was amended.

(e) Commencing in 1930 dividends were paid on the common stock of United Artists Corporation. Under the agreement dividends on the escrowed stock were paid to the escrow agent rather than to the stockholder of record and these dividends were retained pro tem by the escrow agent. As shares of stock were released to petitioner by the escrow agent the accumulated dividends thereon were also released. [4]

(f) At the beginning of 1935 there remained with the escrow agent, 334 shares of petitioner's stock of United Artists Corporation and \$44,532.44 accumulated dividends thereon and in that year United Artists Corporation and petitioner canceled the agreement. The 334 shares

with the accumulated dividends thereon were released by the escrow agent and delivered to petitioner.

(g) The release of the stock from escrow did not result in taxable income to the petitioner.

(h) The accumulated dividends on the 334 shares of stock amounted to \$44,532.22 and were paid to the escrow agent in the following years:

1930.....	\$ 6,680.00
1931.....	3,340.00
1932.....	3,340.00
1934.....	31,172.22
	<hr/>
	\$44,532.22

(i) The \$44,532.22 accumulated dividends released by the escrow agent in 1935 were reported in petitioner's 1935 return as dividend income.

(j) These \$44,532.22 dividends did not constitute taxable income to petitioner for 1935.

(k) Claim for refund of the overassessment resulting from the inclusion of these dividends in petitioner's taxable income for 1935 was filed with the Collector of Internal Revenue at Los Angeles on March 8, 1939.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine:

(a) That there is no deficiency in petitioner's 1935 Federal income tax.

(b) That there is an overpayment of peti-

tioner's 1935 Federal income tax of \$24,938.04.

(c) Such other and further relief as this Board may deem proper.

LOYD WRIGHT

Counsel for Petitioner,
111 West Seventh Street,
Los Angeles, California.

J. R. WHITE

Agent for Petitioner,
530 West Sixth Street,
Los Angeles, California.

Los Angeles, California. May 17, 1939. [5]

State of California

County of Los Angeles—ss.

Charles Chaplin, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition and is familiar with the statements contained therein and that such statements are true to the best of his knowledge and belief.

CHARLES CHAPLIN

Subscribed and sworn to before me this 18th day of May, 1939.

[Seal] ANITA GARRETT

Notary Public in and for the County of Los Angeles, State of California.

My Commission expires March 10, 1941. [6]

EXHIBIT A

SN-IT-1

12th Floor,
U. S. Post Office and Court House,
Los Angeles, California.

Mar. 2, 1939

IT:LA

FHG:90D

Mr. Charles Chaplin,
1416 North La Brea Avenue,
Los Angeles, California.

Sir:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1935 discloses a deficiency of \$65,208.48 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 1200 U. S. Post Office and Court House, Los Angeles. The signing and filing of this form will expedite the closing of your return by permitting an early

assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING, Commissioner,
By (Signed) GEORGE D. MARTIN
Internal Revenue Agent in
Charge.

Enclosures:

Statement.

Form of waiver.

FHG-WSG [7]

STATEMENT

IT:LA

FHG-90D

Mr. Charles Chaplin,
1416 North La Brea Avenue,
Los Angeles, California.

Tax Liability for the Taxable Year Ended
December 31, 1935.

Income tax

Tax liability \$296,064.06

Tax assessed \$230,855.58

Deficiency \$65,208.48

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated January 22, 1938 and February 14, 1939.

The additional assessment of \$6,720.00 for the

taxable year, made pursuant to the waiver of restrictions executed by you under date of December 31, 1937, has been given effect in the computation of the deficiency herein stated.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

A copy of this letter and statement has been mailed to your representative, Mr. J. R. White, 530 West Sixth Street, Los Angeles, California, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

ADJUSTMENTS TO NET INCOME
Taxable year ended December 31, 1935.

Net income as disclosed by return.....	\$445,269.58
Additional income:	
(a) Dividend income of Trust No. 7250, Charles S. Chaplin taxable to you	\$ 12,000.00
(b) Value of 334 shares of stock of United Artists Corporation.....	104,709.00
	116,709.00
Net income adjusted.....	\$561,978.58

EXPLANATION OF ADJUSTMENTS

(a) The income of Trust No. 7250, Citizens National Trust and Savings Bank, Trustee, established by you for the purpose of providing for the care and maintenance of two minor children, is held to be taxable to you. This adjustment forms the basis of the additional assessment to which you have previously assented.

(b) The fair market value of 334 shares of the capital stock of United Artists Corporation received by you in the taxable year, which value has been determined to be \$104,709.00, represents income taxable to you under the provisions of Section 22(a) of the Revenue Act of 1934.

The credit for dividends received, provided for by Section 25 (a) (1) of the Revenue Act of 1934, is adjusted as follows:

Credit claimed in your return.....	\$184,754.07
Plus: Dividends added in item (a) above.....	12,000.00

Total	\$196,754.07
-------------	--------------

Less: An amount of \$44,532.22 reported as dividends in your return, representing accumulated dividends of prior years on the stock dividend mentioned at item (b) above; not dividends received in the taxable year within the meaning of section 25(a)(1)

44,532.22

Corrected dividend credit.....	\$152,221.85
--------------------------------	--------------

COMPUTATION OF TAX

Taxable year ended December 31, 1935

Net income adjusted.....	\$561,978.58
Less: Personal exemption	\$ 1,000.00
Credit for dependents.....	800.00
	<hr/>
	1,800.00
	<hr/>
Balance (surtax net income).....	\$560,178.58
Less: Dividends	\$152,221.85
Earned income credit	
(10% of \$14,000.00).....	1,400.00
	<hr/>
	153,621.85
	<hr/>
Net income subject to normal tax.....	\$406,556.73
Normal tax at 4% on \$406,556.73.....	\$ 16,262.27
Surtax on \$560,178.58.....	279,801.79
	<hr/>
Correct income tax liability.....	\$296,064.06
Income tax assessed:	
Original, account No. 201712.....	\$224,135.58
Additional, January 1938,	
account No. 510159.....	6,720.00
	<hr/>
Total tax assessed.....	230,855.58
	<hr/>
Deficiency of income tax.....	\$ 65,208.48

[10]

TREASURY DEPARTMENT

Internal Revenue Service

12th Floor,

U. S. Post Office and Court House,
Los Angeles, California.

Mar. 2, 1939

Office of
Internal Revenue Agent in Charge
Los Angeles Division
IT:LA-FC
Mr. J. R. White,
530 West Sixth Street,
Los Angeles, California.

Sir:

In re: Mr. Charles Chaplin,
1416 North La Brea Avenue,
Los Angeles, California.

Year: 1935.

There is enclosed a copy of a letter of this date are given above. This copy is furnished in accordance with the authorization contained in power of attorney on file in the Bureau.

Respectfully,

(Signed) GEORGE D. MARTIN
Internal Revenue Agent in
Charge.

Enclosure:

Copy of letter.

[Endorsed]: U.S.B.T.A. Filed May 26, 1939.

[Title of Board and Cause.]

ANSWER

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above entitled proceeding, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (d), inclusive. Denies the allegations of error contained in subparagraphs (a) to (d), inclusive, of paragraph 4 of the petition.

5. (a) Admits that in 1919 the petitioner and others caused United Artists Corporation to be formed and that the petitioner subscribed for 1,000 shares of preferred and 1,000 shares of common stock of said corporation. Denies the remainder of said subparagraph (a) of paragraph 5 of the petition. [12]

(b) Admits the allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d), (e) and (f) Admits the allegations contained in subparagraphs (d), (e) and (f) of paragraph 5 of the petition.

(g) Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h) and (i) Admits the allegations contained in subparagraphs (h) and (i) of paragraph 5 of the petition.

(j) Denies the allegations contained in subparagraph (j) of paragraph 5 of the petition.

(k) Admits the allegations contained in subparagraph (k) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

Respondent denies that the petitioner is entitled to the relief prayed for in the last paragraph of the petition.

Wherefore, it is prayed that the petition be denied and that the respondent's determination be in all respects approved.

Signed J. P. WENCHEL

FTH

J. P. WENCHEL

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

FRANK T. HORNER,

B. M. COON,

Special Attorneys,

Bureau of Internal Revenue.

BMC:W 6/23/39

[Endorsed]: U.S.B.T.A. Filed Jun. 29, 1939. [13]

[Title of Board and Cause.]

AMENDED ANSWER

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for amended answer to the petition filed in the above-entitled proceeding, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (d), inclusive. Denies the allegations of error contained in subparagraphs (a) to (d), inclusive, of paragraph 4 of the petition.

5. (a) Admits that in 1919 the petitioner and others caused United Artists Corporation to be formed and that the petitioner subscribed for 1,000 shares of preferred and 1,000 shares [14] of common stock of said corporation. Denies the remainder of said subparagraph (a) of paragraph 5 of the petition.

(b) Admits the allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) Admits the allegations contained in subparagraph (d) of paragraph 5 of the petition.

(e) Admits so much of subdivision (e) of para-

graph 5 of the petition as alleges that commencing in 1930 dividends were paid on the common stock of United Artists Corporation; that under the agreement dividends on the escrowed stock were paid to the escrow agent and these dividends were retained by the escrow agent; that as shares of stock were released to the petitioner by the escrow agent the accumulated dividends thereon were also released, and denies all other allegations therein contained.

(f) Admits so much of subdivision (f) of paragraph 5 of the petition as alleges that at the beginning of 1935 there remained with the escrow agent 334 shares of stock of the United Artists Corporation and \$44,532.22 accumulated dividends thereon, and that in that year United Artists Corporation and petitioner canceled the agreement; that the 334 shares with the accumulated dividends thereon were released by the escrow agent and delivered to the petitioner, and denies all other allegations therein contained. [15]

(g) Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h) and (i) Admits the allegations contained in subparagraphs (h) and (i) of paragraph 5 of the petition.

(j) Denies the allegations contained in subparagraph (j) of paragraph 5 of the petition.

(k) Admits the allegations contained in subparagraph (k) of paragraph 5 of the petition.

6. Denies generally and specifically each and

every allegation contained in the petition not hereinbefore admitted, qualified or denied.

Respondent denies that the petitioner is entitled to the relief prayed for in the last paragraph of the petition.

Wherefore, it is prayed that the petition be denied and that the respondent's determination be in all respects approved.

(Signed) J. P. WENCHEL

FTH

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

FRANK T. HORNER,

Special Attorney,

Bureau of Internal Revenue.

FTH:FWT 2/21/41

[Endorsed]: U. S. B. T. A. Filed Feb. 26, 1941.

[16]

[Title of Board and Cause.]

FINDINGS OF FACT AND OPINION

Docket No. 98795. Promulgated February 24, 1942.

Certificates for common stock of a corporation were issued in the name of petitioner and

delivered to an escrow agent under an agreement providing that when certain photoplays were delivered to the corporation the certificates would be released to him. The agreement also provided that in the event of failure to deliver such photoplays to the corporation the certificates were to be returned to the corporation, but petitioner was permitted to vote the stock while it was held in escrow. Dividends upon the stock were deposited in a trust account and accumulated until delivery of the certificates to petitioner. Under the evidence it is held that it was the intention of the parties complete ownership of the property should vest only when the certificates were delivered by the escrow agent. The fair market value of the stock when delivered to petitioner in the taxable year was properly included in his gross income. Held, further, that the amounts accumulated in earlier years and paid over to petitioner in the taxable year are dividends rather than ordinary income.

Herschel B. Green, Esq., Loyd Wright, Esq., and J. R. White, C. P. A., for the petitioner.

Frank T. Horner, Esq., and Byron M. Coon, Esq., for the respondent.

The Commissioner determined a deficiency in petitioner's income tax for the calendar year 1935 in the amount of \$65,208.48. The petitioner claims an overpayment in the amount of \$24,938.04.

The petition alleges that the respondent erred:

(a) In including in income the amount of \$104,709, representing the fair market value of certain stock of the United Artists Corporation released from escrow in 1935; (b) in treating as ordinary income \$44,532.22 representing accumulated dividends of the United Artists Corporation released from escrow and paid over to petitioner in 1935; (c) in reducing the credit for dividends received by \$44,532.22 in computing the normal tax; and (d) without prejudice to (a), (b), and (c), in including as income \$44,532.22 dividends paid on the escrowed stock prior to 1935 and released to petitioner in that year. [17]

The proceeding was submitted on a stipulation of facts, oral testimony, and documentary evidence.

Findings of Fact

The petitioner is a resident of Los Angeles, California. He filed his income tax return for 1935 with the collector of internal revenue at Los Angeles, California, on March 16, 1936, showing a total tax due of \$224,135.58 which was paid to the collector on the following dates:

March 16, 1936.....	\$56,033.90
June 15, 1936.....	56,033.90
Sept. 12, 1936.....	56,033.89
Dec. 15, 1936.....	56,033.89
Total.....	<hr/> 224,135.58

On February 8, 1938, a deficiency of \$7,487.89 principal and interest, assessed against petitioner for 1935, was paid to the collector according to agreement. A claim for refund of any overassess-

ment resulting from the inclusion of the \$44,532.22 in petitioner's income was filed by petitioner on March 8, 1939.

On February 5, 1919, the petitioner, Douglas Fairbanks, and Mary Pickford, artists, and David W. Griffith, producer, entered into an agreement to associate themselves together in the distribution of motion pictures thereafter produced by them. All of the parties were favorably known in all parts of the world where motion pictures were exploited and exhibited and their respective names had exceptional trade value. The agreement provided, among other things, that they would organize a corporation to be known as the United Artists Corporation (hereinafter sometimes referred to as the corporation) with two classes of stock, class A—6,000 shares of 8 percent cumulative preferred stock, par value \$100 per share, and class B—9,000 shares of common stock, no par value. Each of the parties was to purchase 1,000 shares of the preferred stock at \$100 per share, it being contemplated that this stock would be redeemed by the corporation. The common stock was to be issued and paid for in the following manner:

One thousand (1,000) shares to each of the above named persons in part consideration of the execution and fulfillment of the contract pertaining to the exploiting, marketing, distributing and turning to account of his or her motion pictures with the said corporation. The details concerning the delivery of the aforesaid common shares of stock to each of the aforesaid persons shall be more fully set forth in the agreement between said person and

said corporation pertaining to the exploiting, marketing, distributing and turning to account the motion pictures produced by such person and included in such contract. [18]

One thousand (1,000)shares to William G. McAdoo who is to become the General Counsel of said corporation.

All of the common stock was to be issued "subject to the right of the corporation for its then existing stockholders to repurchase the same in the event of such stockholder desiring to sell any portion or all of his or her shares of common stock in said corporation to any person who is now [sic—not] actively associated with such stockholder in the business of producing photoplays * * *." The substance of this provision was included in the bylaws subsequently adopted by the corporation.

On April 17, 1919, the certificate of incorporation of United Artists Corporation was filed with the Secretary of State of Delaware. It authorized the issuance of 5,000 shares of preferred stock, \$100 par value, and 9,000 shares of common stock. The preferred stock was to have no voting rights. Each holder of shares of common stock was entitled to as many votes at all elections of directors as his number of shares multiplied by the number of directors to be elected.

On February 5, 1919, petitioner signed a proposed distribution agreement which was subsequently executed by the corporation on June 13, 1919. Similar agreements were signed by Douglas Fairbanks, Mary Pickford, and D. W. Griffith. The agreement signed by petitioner provided, among other things,

that he would produce and deliver to the corporation nine photoplays of between 1,600 and 3,000 feet in length within three years from the date thereof. The corporation obligated itself to give petitioner's name "chief prominence" in the advertisements of his pictures, to use its best efforts to market the films upon a basis of sharing in gross receipts, and agreed that no franchise or territorial right for the use of such photoplays should be made without his written consent. Subdivision (i) of the "Third" paragraph of this agreement reads as follows:

(i) And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation, nine (9) photoplays. Should said artist be unable to deliver nine (9) such photoplays because of illness or incapacity during the said entire period of three (3) years, said artist shall receive so many of the aforesaid one thousand (1,000) shares of the common stock of this corporation as the number of photoplays delivered by said artist to this corporation pursuant to this agreement bears to the number of nine. The balance of the shares of such common stock shall be delivered by such escrow agent to this corporation. [19]

At a special meeting of the board of directors of United Artists Corporation held on May 29, 1919, the following resolution was adopted:

Whereas in the judgment of the Board of Directors the photoplays agreed to be delivered to this Corporation under said contracts are necessary for the business of this Corporation and constitute good and sufficient consideration for the issue of five

thousand (5000) shares of the common stock of this corporation, the same being without par or nominal value:

Resolved that, in consideration of the delivery of said contracts to this Corporation the proper officers of this Corporation be, and they hereby are, authorized to issue and deliver to William G. McAdoo, Esq., one thousand (1,000) shares of no par value of this corporation fully paid and non-assessable, said shares to include the shares of no par value subscribed for by the signers of the certificate of incorporation of this Corporation, assignments of said subscriptions being held by him; and

Resolved that, in consideration of the delivery of said contracts of this Corporation, the proper officers of this Corporation be, and they hereby are authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) one thousand (1,000) shares of no par value each, making a total of four thousand (4,000) shares of no par value to a person or corporation to be agreed upon by said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation, and to no other person, said four thousand (4,000) shares to be held by said person or corporation in escrow in accordance with the provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation; and

Resolved that the proper officers of this Corporation be, and they hereby are, authorized and directed to execute an escrow agreement for the holding and delivery of said four thousand (4,000) shares of non-par value in accordance with the terms and provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation dated February 5th, 1919, said escrow agreement to provide that while

said four thousand (4,000) shares are held in escrow, each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this corporation before execution of the same by its officers.

On June 9, 1919, the corporation issued 9 certificates of stock—8 for 111 shares each and one for 112 shares—in which petitioner was shown as the owner. The certificates were not delivered to petitioner, but were kept in the possession of the corporation until subsequently delivered to and deposited with the escrow agent in accordance with the agreement between petitioner and his associates and with the corporation. [20]

The following entry appears in the journal of United Artists Corporation:

June 9 [1919] Artists' Contracts.....A-4	\$25,000.00
Consideration for contracts with the four artists for delivery of photoplays to Corporation as per resolution of Board of Directors adopted May 29, 1919 (ratified by stockholders, Sept. 9, 1919)	
Capital Stock—CommonC-7	\$25,000
Issued 5,000 shares at no par value, but regarded to have a value of \$5.00 per share (verbal advice of General Counsel)	

On July 5, 1919, the petitioner, Douglas Fairbanks, Mary Pickford, and D. W. Griffith entered into an agreement with the United Artists Corporation amending subdivision (i) of paragraph 3 of their respective agreements of February 5, 1919, as follows:

And in addition to the above consideration, one

thousand (1,000) shares of the common stock of the said corporation to be issued in the name of the said Artist in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each and one of which shall be for one hundred and twelve (112) shares, said certificates to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto. Upon delivery by the said Artist to the said corporation of each one (1) of the first eight (8) photoplays called for by this contract, such escrow agent shall deliver to the said Artist one (1) of said certificates for one hundred and eleven (111) shares, and upon delivery by the said Artist to the said corporation of the ninth (9th) photoplay called for hereunder, such escrow agent shall deliver to the said Artist said certificate for one hundred and twelve (112) shares. Upon the expiration of the three-year period herein provided for, so many of said certificates as are then still held by such escrow agent in accordance with the provisions of this paragraph shall be delivered by such escrow agent to the said corporation.

On August 5, 1919, the petitioner, the United Artists Corporation and one Dennis F. O'Brien, an escrow agent, entered into an agreement providing inter alia as follows:

First: The Corporation shall forthwith deliver to, and deposit with, the Depositary the nine (9) stock certificates, representing in the aggregate one thousand (1,000) shares of the common stock of the Corporation, which have been issued in the name of the Artist as aforesaid.

Second: Upon receipt of said stock certificates, the Depositary shall issue in respect thereof in the name of the Artist a certificate of deposit. * * *

Third: Upon delivery by the Artist to the Corporation of each one (1) of the first eight (8) photoplays called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that

the Artist is entitled to one (1) of said certificates for one hundred and eleven (111) shares, whereupon the Depositary shall deliver one (1) of the same to the Artist upon surrender by the latter of the certificate of deposit herein provided for and shall issue to the Artist a new certificate of deposit, substantially in the form of that annexed hereto, in respect of the number of shares remaining in escrow. Upon delivery [21] by the Artist to the Corporation of the ninth (9th) photoplay called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to said certificate for one hundred and twelve (112) shares, whereupon the Depositary shall deliver the same to the Artist upon surrender by the latter of the certificate of deposit which he then holds. At the expiration of said period of three years, the Depositary shall deliver to the Corporation so many of the certificates deposited hereunder as then remain in escrow and are not the property of the Artist, and the Artist shall return to the Depositary the certificate of deposit which he then holds.

Fourth: Any and all dividends which may be declared upon the shares of stock represented by the certificates deposited hereunder while the same, or any part thereof, are held in escrow by the Depositary shall be deposited by the Corporation in the Central Union Trust Company, No. 80 Broadway, New York City, in an account to be known as "United Artists Corporation, Trust Account No. 1." Upon delivery to the Artist by the Depositary, in the manner hereinbefore provided for, of each of the certificates deposited hereunder, the Corporation shall pay to the Artist one-ninth ($1/9$) of all dividends which at the time of such delivery shall have been deposited in said account, together with accrued interest thereon. At the expiration of said period of three years, so much of such dividends and interest thereon as remain in said account and are not due the Artist shall become the property of the Corporation.

Fifth: The Depositary shall not have the right to vote the shares of stock deposited hereunder.

* * * * *

Seventh: This agreement shall be binding upon the heirs, legal representatives, successors and assigns of the parties hereto.

The form of the certificate of deposit was as follows:

	Certificate of Deposit.	
No.		No. of Shares
	Certificate of Deposit	

representing the Common Stock of United Artists Corporation.

This Is to Certify that there have been deposited with Dennis F. O'Brien (herein called the "Depositary"), under a written agreement, dated
....., 1919, (a copy of which is on file at the office of Depositary), for the benefit of Charles Chaplin (herein called the "Beneficiary"), nine (9) stock certificates representing in the aggregate one thousand (1000) shares of common stock of United Artists Corporation, without par value, and that under said agreement the Beneficiary will be entitled to a delivery of said stock certificates or some portion thereof upon surrender hereof and upon receipt by the Depositary of a written notice from United Artists Corporation that the Beneficiary is entitled thereto under the terms of said agreement.

The holder of this certificate of deposit shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation.

Petitioner did not deliver any motion pictures to the corporation during the three-year period contemplated in the agreement of February 5, 1919, nor was any modification of the agreement made

during the three-year period extending the time in which the nine motion pictures should be delivered; but all the parties to the agreement continued to treat the agreement as in full force and effect. Upon the [22] expiration of the three-year period none of the 1,000 shares of stock held in escrow under the contract with petitioner was delivered back to the corporation, nor was any demand made upon the escrow agent by the corporation, or any of its officers, directors, or stockholders that such shares of stock be returned to the corporation. At the end of the three-year period none of the parties to the agreements had delivered all of the nine pictures required by their contracts to the corporation; but the depository did not turn back to the corporation any of the stock standing in their names and held by him in escrow.

In 1923 petitioner delivered to the corporation one photoplay, "Woman of Paris" which was released November 4 of that year. At that time the escrow agent turned over to him one certificate for 111 shares of stock. This left eight pictures undelivered by petitioner under his contract and eight certificates of stock still held by the escrow agent.

On November 22, 1924, the petitioner, Mary Pickford, Douglas Fairbanks, Joseph Schenck, and United Artists Corporation entered into an agreement further modifying the distribution agreement of February 5, 1919. As modified, it recites that "Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all of the preferred and common stock of the corporation, now issued and outstand-

ing'' except certain qualifying shares, and provides, among other things, that in addition to the nine pictures originally contracted for, Pickford will produce six feature photoplays and Fairbanks will produce five, all to be delivered by November 1, 1928; but neither "shall receive any additional common stock" beyond the amounts provided to be delivered to them during the term of their original contract. The agreement also provides that petitioner will produce five pictures to be delivered one each year, all to be delivered on or before January 1, 1929, instead of the eight undelivered pictures provided for in the original contract, and "The balance of the common stock of the corporation, which is now held in escrow for the benefit of Chaplin shall be delivered to him in the proportion of one-fifth ($1/5$) thereof upon the delivery of each motion picture photoplay by Chaplin to the corporation."

Thereafter petitioner produced and delivered to United Artists Corporation three pictures which were released on the following dates: "The Gold Rush"—August 16, 1925; "The Circus"—January 7, 1928; and "City Lights"—March 1, 1931.

On October 31, 1928, petitioner delivered to the corporation the certificate for 111 shares of its common stock which had been released from escrow upon the delivery of the photoplay "Woman of Paris", and at said time the 889 shares still held in escrow by Dennis F. O'Brien were delivered to the corporation. All of the [23] certificates of stock were forthwith canceled, and on the same date the

corporation issued in the name of petitioner the following certificates of common stock: #83 for 166 shares; #84 for 167 shares; #85 for 166 shares; #86 for 167 shares; #87 for 167 shares; and #88 for 167 shares; a total of 1,000 shares. All of the foregoing certificates were placed in escrow with Dennis F. O'Brien pursuant to the agreement dated February 5, 1919, as amended. Thereafter on November 8, 1928, there were released from escrow and delivered to petitioner certificates #83 for 166 shares; #84 for 167 shares, and #85 for 166 shares of the common stock of the corporation.

On February 27, 1931, certificate #86 for 167 shares was released from escrow and delivered to petitioner upon completion of the picture "City Lights."

All of the pictures delivered by petitioner to the corporation were much longer than the 1,600 to 3,000 feet specified in the agreement.

On September 20, 1935, an agreement was entered into between petitioner and the corporation under which certificates Nos. 87 and 88 for 167 shares each were released to petitioner, together with accumulated dividends thereon in the sum of \$44,532.22, which had been paid to the escrow agent in the following years:

1930.....	\$ 6,680.00
1931.....	3,340.00
1932.....	3,340.00
1934.....	31,172.22
<hr/>	
Total.....	44,532.22

The dividends had been deposited in a special bank account and interest on such deposits in the amount of \$995 was paid to the petitioner when the stock and dividends were released. This amount was included in gross income in petitioner's income tax return for 1935.

The 1,000 shares of common stock issued to William Gibbs McAdoo were surrendered to the corporation in 1920. Subsequently, in 1924, 1,000 shares were issued to Joseph M. Schenck. The stock referred to in this paragraph was never put in escrow.

When the original 9 certificates totaling 1,000 shares of stock were put in escrow, petitioner did not sign them. When these certificates were canceled by the corporation and 6 certificates totaling 1,000 shares were issued in their stead and placed in escrow, petitioner signed these 6 certificates in blank.

After the organization of the corporation petitioner attended stockholders' meetings, voted at such meetings for directors and otherwise, received notices, and signed proxies the same as any stockholder. He was carried on the books of the corporation as the owner of 1,000 shares [24] of common stock. The dividends upon the stock standing in his name were deposited in a trust account in a New York bank in accordance with the escrow agreement.

In computing the deficiency here in issue the respondent determined the fair market value of the 334 shares of common stock of the United Artists

Corporation, delivered to petitioner from escrow in 1935, to be \$104,709 and added this amount to petitioner's income for that year.

In his income tax returns for 1935 petitioner treated the \$44,532.22 as dividends received in that year and not subject to the normal tax. The respondent determined that the \$44,532.22 did not represent "dividends" received in the taxable year and the amount was treated as ordinary income in determining the deficiency in tax.

Opinion

Mellott: The first question is whether respondent erred in including in petitioner's income the fair market value of the stock released from escrow and delivered to him in 1935. This question may be answered by determining whether petitioner owned the shares prior to their delivery to him in that year.

Petitioner contends that ownership vested in him on June 9, 1919, when certificates for 1,000 shares were issued; that the consideration for the issuance of the shares was the execution by him of the distribution agreement of February 9, 1919; that the shares were placed in escrow merely as security for the performance of his part of the contract; that the "dividends" were impounded "to encourage compliance by each artist with his distribution contract"; that he was regarded by the corporation as the owner, at all times, of the stock and "exercised all incidents of ownership", except physical possession; and that he realized no taxable income when the stock was released from escrow and delivered to him.

Respondent determined that "the fair market value of the 334 shares * * * received * * * in the taxable year which value has been determined to be \$104,709, represents income taxable to [petitioner] under the provisions of section 22 (a) of the Revenue Act of 1934." In support of this determination respondent places considerable reliance upon the provisions of the agreement of August 5, 1919 (escrow agreement); contends that the entire record shows petitioner was not the owner of the 334 shares until they were released and delivered to him in 1935; argues it was the intention of the parties, as indicated by the various exhibits, that petitioner should not become the owner of the stock until and unless the photoplays were delivered; and insists that petitioner acquired no vested interest in it until he delivered the photoplays according to his agreement. The value of the stock [25] at the time it was released from escrow and delivered to petitioner is not contested.

Title to personal property generally passes when the parties to a transaction intend that it shall pass. *United States v. Utah, Nevada & California Stage Co.*, 199 U. S. 414. Intention is primarily a question of fact. In determining it the agreements which they signed, if unambiguous, are entitled to great weight, though consideration may also be given to the circumstances under which they were executed, the objects sought to be accomplished, the interpretation placed upon them by the parties prior to the controversy in issue, and any and all

relevant facts and circumstances tending to show what the actual intention was. The basic facts, which are not seriously in dispute, are shown in our findings. No attempt will be made to summarize them. Brief allusion will, however, be made to some of them.

On February 5, 1919, petitioner and other artists, for reasons immaterial here, agreed in writing to become associated in the organization of a corporation for the purpose of exploiting, distributing, and exhibiting motion pictures produced by them. This agreement provided that 1,000 shares of the common stock of such corporation should be issued to each of the parties and paid for "in part consideration of the execution and fulfillment" by each of a contract pertaining to the exploiting, marketing, and distributing of his or her motion pictures. Pursuant to this agreement, petitioner entered into a contract with the corporation for exploiting, marketing, and distributing 9 motion pictures to be produced by him, and an agreement with the corporation and an escrow agent was prepared and signed. These agreements set out the terms and conditions under which the 1,000 shares of common stock (which included the 334 shares here in question) were to be issued and delivered to petitioner. The terms and conditions were specific and definitely provided that petitioner should not receive any of the 1,000 shares of common stock unless and until he had produced and delivered one or more photoplays, and that all of the stock should be

received when, and only when he had delivered the required number of photoplays.

The later agreement of November 22, 1924, is equally positive in its terms. Under it petitioner became "obligated to deliver to the corporation for distribution only five (5) additional photoplays, described in the original contract instead of eight (8) undelivered pictures provided for in said contract. The balance of the common stock of the corporation, which is now held in escrow for the benefit of Chaplin shall be delivered to him in the proportion of one-fifth ($1/5$) thereof upon the delivery of each motion picture photoplay by Chaplin to the Corporation." (One-sixth of the total 1,000 shares was delivered to petitioner leaving five-sixths in escrow.) This agree- [26] ment was partially carried out and under it the escrow agent delivered three additional certificates of stock to petitioner prior to 1935. The other two—the two in issue in this proceeding—were released by the corporation and delivered to petitioner in September 1935.

The terms and conditions of the agreements briefly referred to above and the actions of the parties under them indicate, in our judgment, it was the intention of the parties that ownership of the stock should not pass to petitioner until and unless he "fulfilled" the terms and conditions of his contract and delivered to the corporation the photoplays stipulated therein. In reaching this conclusion we have not overlooked the fact that the corporation prior to 1935 treated petitioner, for many pur-

poses, as the owner of 1,000 shares of its common stock. Clearly, all parties intended that he should ultimately become such owner; and, since he was permitted under the escrow agreement to vote the stock, it is not surprising that he was given the usual notice of meetings, participated in elections, and exercised other rights commonly exercised only by a stockholder. The right to vote corporate stock may be conferred by contract, as it was in the instant proceeding, even though no property in the stock has passed, cf. *Cattlemen's Trust Co. of Fort Worth v. Turner*, 182 S. W. 438. Stock is frequently voted by persons having no beneficial ownership of it. *Alger-Sullivan Lumber Co. v. Commissioner*, 57 Fed. (2d) 3. Nor do we think that the recitation in the corporate resolution of May 29, 1919, to the effect that the corporation was authorized to issue stock to the artists "in consideration of the delivery of [the distribution] contracts", justifies a conclusion that the artists thereby became the "owners" of the stock; for the shares were to be held "in escrow in accordance with the provisions of said contracts" and were so held.

The whole idea of the enterprise was cooperative. The corporation was formed for the specific purpose of distributing pictures of the artists. Each agreed to execute a contract with the corporation for the exclusive right "to market, exploit, distribute and turn to account the motion pictures that each shall produce." The contract ultimately entered into by petitioner with the corporation granted it

“the exclusive right and privilege to market and turn to account, exhibit, distribute or cause to be distributed or exhibited” the pictures which he was to produce. “All moneys derived from the license to use” the pictures were to be divided 70 or 80 percent to the artist and 20 or 30 percent to the corporation. It is apparent the corporation would have no income unless the pictures, either those produced by petitioner or those produced by the other artists, were delivered to it for distribution and exploitation. The artists did not contemplate that one of them should share in the profits of the corporation—except to a limited extent as purchasers and owners of the preferred stock— [27] unless he delivered his proportion of the pictures which were to produce the income. The mere execution of the contract was not sufficient. The “fulfillment” of the contract was equally important. Indeed it was the very essence, the sine qua non of the contract, a condition precedent to petitioner acquiring either equitable or legal ownership of the common stock. Cf. *United States v. Fourth National Bank in Wichita, Kansas*, 83 Fed. (2d) 85. We are therefore of the opinion that petitioner’s contention, to the effect that ownership of the stock vested in him on June 9, 1919, is untenable. He became the owner of the stock in 1935 when it was released from escrow, by the corporation, and delivered to him. In this connection it may be pointed out that the escrow agreement required the depository to hold the stock until “the corporation shall notify

* * * [it] in writing that the artist is entitled" to receive it and this agreement was carried out.

Petitioner places considerable reliance upon the decision of the District Court for the District of New Jersey in *Schneider v. Duffy*, 43 Fed. (2d) 642, and *H. L. Carnahan*, 21 B. T. A. 893. The cited cases are, in our judgment, distinguishable upon their facts. In the first mentioned case there was a conditional assignment to the taxpayer of an equitable ownership in 1,500 shares of stock in consideration of his agreement to remain with the corporation for five years. He was "to receive and enjoy all dividends declared and paid from the date" of the assignment, including any distribution "of money, property, stocks or rights that the common stockholders * * * become entitled to * * *." One-fifth of the shares were to be delivered to him at the end of each year during the five-year period; but in the event of his death or refusal to carry out his obligation, the equitable assignment as to the undelivered stock was to be null and void. In deciding that the parties intended ownership of the stock to vest when the contract was signed rather than when delivery was made at the end of the year, the court emphasized the fact that the taxpayer acquired a present, fixed right to the enjoyment of all the income of the property when the contract was signed and that the parties had specifically agreed the undelivered stock was "intended only as collateral security" that the employee would carry out his obligation. In the instant case the div-

idends were to be held in escrow and delivered to the petitioner only when and if the stock should be delivered to him. Here, also the stock was not held as collateral security for the performance of petitioner's obligation but remained the property of the corporation until "delivery by the artist to the corporation" of the photoplay as agreed.

In H. L. Carnahan, the petitioner, in 1922, had performed services entitling him to receive 5,000 shares of corporate stock. The stock was issued to him and he became entitled to receive all dividends [28] and to exercise all rights as a stockholder; but the certificate was required to be, and was, delivered in escrow pending further order of the "Blue Sky" Commissioner. The certificate was released and delivered to the petitioner in 1924 and the question before the Board was whether he was in receipt of income in the earlier year or in the later year. In holding that income was realized in 1922 it was pointed out that the taxpayer had received the stock in that year, had deposited it in escrow in accordance with the requirements of the state law, and "received all the benefits possible from * * * [it] except the right of actual physical possession and unrestricted power of sale * * *." In the instant proceeding petitioner did not receive such "benefits" from the stock and could not receive them unless and until he complied with his obligation.

It is apparent we must hold, and we do hold, that petitioner became the owner of the 334 shares of

stock in 1935 rather than in 1919. The following cases, in addition to those heretofore cited and discussed, tend to support this view. Martin D. Thomas, 44 B. T. A. 735; Charles F. Mitchell, 45 B. T. A. 300.

Issues (b), (c), and (d) require determination of the treatment to be accorded the accumulated dividends. Respondent contends that if petitioner was not the owner of the shares of stock prior to 1935, then the amount representing dividends declared on the stock prior to that date did not represent dividends to him. The gist of his contention seems to be that the sum paid over to petitioner was merely an additional amount paid for fulfilling the contract. The question is not free from doubt; but we think we are justified in resolving it in favor of petitioner. The amount deposited in escrow represented the portion of the earnings of the corporation allocable to the shares of stock which, under the contract, the parties intended should ultimately belong to petitioner. The contract provided that if and when the stock should be delivered to petitioner by the escrow agent, the corporation would pay to him all dividends which had been deposited in the trust account. This was done. If the amounts deposited in the trust account represented dividends—and they seem clearly to have been distributions by the corporation out of earnings or profits accumulated after February 28, 1913, and hence within the definition of a dividend contained in section 115 of the Revenue Act of 1934—then they did not

lose their character as dividends merely because they were not actually delivered to petitioner in the year declared. The right to receive dividends may be assigned without making the assignee a stockholder, Roscoe H. Aldrich, 3 B. T. A. 911, 919; Anthony Schneider, 3 B. T. A. 920, 926; Matchette v. Helvering, 81 Fed. (2d) 73, though some question may arise as to the taxability of the dividends to the assignor under the rationale of such cases as [29] Helvering v. Horst, 311 U. S. 112, and Helvering v. Eubank, 311 U. S. 122. That question, however, is not before us. Both parties admit that the amount should be included in petitioner's income and the issue is solely whether it constituted dividends, as reported, or ordinary income. Since the amount set aside did not, in our opinion, lose its character as dividends, we think it was properly treated by the petitioner in his return. But if respondent's view be accepted that the amounts set aside in each year were not true dividends, then it would seem that the action of the corporation in the taxable year, making them unconditionally available to petitioner, was tantamount to the declaration and payment by the corporation of a dividend in the aggregate amount of \$44,532.22 upon the 334 shares which petitioner had just received. In either event, we are of the opinion that the amount was "received as dividends from a domestic corporation which is subject to taxation" under Title I of the Revenue Act of 1934 and hence the credit for normal tax, as specified in section 25 (a) of such act, should be allowed.

The deficiency shall be recomputed in accordance with the views herein expressed and

Reviewed by the Board.

Decision will be entered under Rule 50.

Sternhagen, dissenting: In my opinion, the amount received by petitioner from the escrow agent which was attributable to the accumulated dividends which the escrow agent had received from the corporation was not received by petitioner as dividends and is not the subject of normal tax credit.

Leech, dissenting: I think the two basic holdings in the majority opinion, expressed in the headnote, are inconsistent with each other and are both wrong. In my judgment, the stock in United Artists Corporation was intended to be and was received by the petitioner in 1919 when it was issued in the name of petitioner and delivered to the escrow agent. It was taxable to petitioner, when so received, as income in the amount of its then fair market value. The stock was held by the escrow agent merely to guarantee performance of petitioner's contract to deliver pictures. The dividends declared and paid on this stock were taxable to petitioner as such when received by the escrow agent. See *Bonham v. Commissioner*, 89 Fed. (2d) 725, affirming 33 B. T. A. 1100. [30]

United States Board of Tax Appeals
Washington

Docket No. 98795

CHARLES CHAPLIN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to findings of fact and opinion herein promulgated February 24, 1942, directing that decision be entered under Rule 50, Respondent on March 20, 1942, filed a proposed computation to which petitioner agreed. It is therefore

Ordered and Decided that there is a deficiency in income tax herein for the year 1935 in the amount of \$63,427.19.

[Seal]

(Signed)

ARTHUR J. MELLOTT
Member.

Enter:

Entered Apr. 6, 1942. [31]

[Title of Circuit Court of Appeals and Cause.]

PETITION FOR A REVIEW OF THE DE-
CISION OF THE UNITED STATES BOARD
OF TAX APPEALS

To the Honorable, the Judges of the United States
Circuit Court of Appeals for the Ninth Circuit.

Now comes Charles Chaplin, by his attorneys,
Lloyd Wright, Charles E. Millikan and Herschel B.
Green, and respectfully shows:

I.

JURISDICTION

The petitioner is a resident of Los Angeles County, California, and filed his federal income tax return for the [32] calendar year 1935 with the Collector of Internal Revenue at Los Angeles, California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The petitioner, in pursuance of Section 1002 of the Revenue Act of 1926, as amended by Section 519 of the Revenue Act of 1934, Sections 1141 and 1142 Internal Revenue Code, seeks a review of the decision of the United States Board of Tax Appeals, promulgated on the 24th day of February, 1942, (46 B.T.A. No. 49) and entered on the 6th day of April, 1942 in the case of Charles Chaplin, Petitioner v. Commissioner of Internal Revenue, Respondent, number 98795 under docket of said Board, wherein said Board determined a deficiency of income tax against petitioner for the calenar year 1935 in the amount of \$63,427.19.

The Respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding office by virtue of the laws of the United States.

II.

NATURE OF CONTROVERSY

The question presented is whether the Respondent erred in including in petitioner's income for 1935 the fair [33] market value of stock issued in the name of Petitioner in 1919 and released from escrow and delivered to him in 1935.

On February 5, 1919 petitioner, Douglas Fairbanks, Mary Pickford, David W. Griffith, all being favorably known in all parts of the world where motion pictures were exhibited agreed to organize a corporation to be known as United Artists Corporation. Each party purchased one thousand shares of preferred stock at One Hundred Dollars (\$100.00) per share and received one thousand shares of common stock in part consideration of the execution and fulfillment of a contract pertaining to the exploiting, marketing and distributing of his or her motion pictures with the said corporation, which contract was also dated February 5, 1919 and executed by the corporation on June 13, 1919. Petitioner's and each other party's one thousand shares of common stock in said corporation were placed in escrow to be held by the escrow holder until each person delivered to the corporation nine photoplays with the proviso that one-ninth of each party's stock would be released for

each photoplay delivered. The Petitioner's contract was later amended to provide for six pictures to be delivered by petitioner in lieu of the nine called for in the original contract and for each picture so delivered by petitioner there would be delivered to him by [34] the escrow holder one-sixth of the stock held in escrow. None of the parties, including petitioner, delivered to the corporation his quota of nine pictures within the period called for in the original contract; there was no extension of the contract and no default declared by the corporation, although it had the right to declare a default and to require the delivery to it of the shares held in escrow as security. The corporation set up in its books as consideration for the issuance of the common stock the artists contracts at a valuation of Twenty-five Thousand Dollars (\$25,000.00). The contracts were approved by the Board of Directors of the corporation. On September 20, 1935, after petitioner had delivered to the corporation four motion picture photoplays, a new distribution agreement was entered into between the corporation and petitioner and at said time there was delivered to petitioner the remaining three hundred thirty-four (334) shares of common stock then held in escrow, together with dividends accumulated thereon and also held in escrow in the sum of \$44,532.22.

During the period of time petitioner's common stock was held in escrow petitioner attended stockholders meetings, voted at such meetings for directors and otherwise, received notices, signed proxies

the same as any other stockholder, [35] participated in the affairs of the corporation, and exercised every incident of ownership in connection with said one thousand shares of common stock. He did not have physical possession of the certificates nor the right to receive dividends declared on the shares in escrow until the shares were released from the escrow. During the time the petitioner's stock was held in escrow the corporation regarded petitioner as the owner of one thousand shares of common stock by entries in its corporate minutes and all other records. Petitioner was recognized as the owner of said shares by the escrow holder as shown by an affidavit of the escrow holder made before any controversy had arisen with reference to such ownership. The shares of stock were placed in escrow as security for the delivery by petitioner of the pictures to United Artists Corporation called for in the distribution agreement.

The petitioner contended that he became the owner of the one thousand shares of common stock in 1919 when the same were issued to him; he later filed a claim for refund of tax paid on the dividends received in 1935 on the theory that the dividends received by him in 1935 were taxable to him in the year declared and paid by the corporation and not in the year received by petitioner. The respondent determined that petitioner became the owner of the 334 shares of common stock [36] in 1935, the year they were released from escrow and delivered to petitioner and that the fair market value of said

shares in 1935, to wit, the sum of \$104,709.00 should be added to petitioner's income for that year.

The Board held that Petitioner became the owner of the stock in 1935 when it was released from escrow by the corporation and delivered to him.

III.

DESIGNATION OF COURT OF REVIEW

The petitioner, being aggrieved by the said findings of fact, opinion, decision and order of the Board, and being a resident of the County of Los Angeles, State of California, and within the Ninth Circuit, desires a review thereof by the United State Circuit Court of Appeals for the Ninth Circuit within which Circuit is located the office of the Collector of Internal Revenue with whom petitioner filed his income tax return for the calendar year 1935 involved herein.

IV.

ASSIGNMENTS OF ERROR

The petitioner avers that in the record and proceedings before the Board of Tax Appeals and in the opinion and final decision rendered and entered by the Board of Tax Appeals manifest error occurred and intervened to the prejudice of [37] the petitioner who now assigns the following errors and each of them which he avers occurred in said record, proceedings, opinion and final decision so rendered and entered by the Board of Tax Appeals.

The Board of Tax Appeals erred:

1. In holding that there is a deficiency of

\$63,427.19 in petitioner's income tax for the year 1935.

2. In holding that petitioner became the owner of 334 shares of common stock of United Artists Corporation in 1935 when said stock was released from escrow and delivered to petitioner.

3. In failing to hold that petitioner became the owner of the 334 shares of common stock when issued to petitioner in 1919.

4. In failing to hold that said one thousand shares of common stock issued to petitioner in 1919 constituted a consideration for the execution by petitioner of the distribution agreement.

5. In failing to hold that the shares of common stock were held by the escrow agent as security for the performance by petitioner of his contract to deliver pictures.

6. In failing to hold that it was the intention of all parties to the original contract that petitioner should become the owner of said shares of common stock when issued in 1919.

7. In failing to hold that the dividends declared and paid on said common stock when held in escrow constituted income to petitioner in the years in which said dividends were paid.

8. In holding that said dividends constituted taxable income to petitioner in 1935.

9. In holding that the fair market value of the 334 shares of common stock, namely, \$104,709.00, constituted taxable income to petitioner in 1935.

10. In holding that petitioner derived income from the release from escrow and delivery to petitioner of the 334 shares of common stock in 1935.

11. In that its decision was not supported by the evidence and is contrary to law.

12. In rendering decision for the respondent and against petitioner. [39]

Wherefore, petitioner respectfully prays that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with law and with the rules of said court and transmitted to the Clerk of said Court for filing and that appropriate action be taken to the end that the record complained of may be reviewed by said court and that said court determine that there is no deficiency due by the petitioner in this proceeding and for such other and further relief as the court may deem meet and proper in the premises.

Respectfully submitted,

(s) LOYD WRIGHT,

111 West Seventh Street,
Los Angeles, California

CHARLES E. MILLIKAN,
111 West Seventh Street,
Los Angeles, California

HERSCHEL B. GREEN,
111 West Seventh Street,
Los Angeles, California

Counsel for Petitioner [40]

State of California,
County of Los Angeles—ss.

Loyd Wright, being first duly sworn, deposes and says:

That he is an attorney authorized to practice before the United States Board of Tax Appeals and the United States Circuit Court of Appeals for the Ninth Circuit, and has his office at 111 West Seventh Street, Los Angeles, California; that he is one of the attorneys of record for the petitioner named in the foregoing petition and is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his knowledge except as to the matters therein alleged on information and belief and as to those matters he believes it to be true.

LOYD WRIGHT

Subscribed and sworn to before me this 1st day of June, 1942.

(Notarial Seal) ANITA GARRETT

Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: U. S. B. T. A. Filed Jun. 8, 1942.[41]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 98795

CHARLES CHAPLIN,

Petitioner,

v.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

NOTICE OF FILING PETITION FOR
REVIEW

To: J. P. Wenchel, General Counsel,
Bureau of Internal Revenue,
Washington, D. C.

Please take notice that the Petitioner on the 8th day of June, 1942, filed with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the Assignments of Error as filed is hereto attached and served upon you.

Dated at Los Angeles, California, this 5th day of June, 1942.

Respectfully,

LOYD WRIGHT,

CHARLES E. MILLIKAN,

HERSCHEL B. GREEN,

By LOYD WRIGHT

Counsel for Petitioner

111 West Seventh Street

Los Angeles, California

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 8th day of June, 1942.

J. P. WENCHEL

W

Chief Counsel, Bureau of Internal Revenue.

Counsel for Respondent on Review [42]

[Title of Circuit Court of Appeals and Cause.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now Comes the Commissioner of Internal Revenue, by his attorneys Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief

Counsel, Bureau of Internal Revenue, and John M. Morawski, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

JURISDICTION

The petitioner on review, is the duly appointed, qualified and acting Commissioner of Internal Revenue, (hereinafter referred to as the Commissioner), holding his office by virtue of the laws of the United States.

The respondent on review, Charles Chaplin, (hereinafter referred to as the taxpayer), is an individual with address at 1416 North LaBrea Avenue, Los Angeles, California. The taxpayer filed his Federal income [43] tax return for the calendar year 1935 with the Collector of Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The Commissioner files this petition pursuant to the provisions of sections 1141 and 1142 of the Internal Revenue Code.

II.

PRIOR PROCEEDINGS

On May 2, 1939, the Commissioner determined a deficiency in income tax for the calendar year 1935 in the amount of \$65,208.48, and sent to the taxpayer by registered mail a notice of said deficiency

in accordance with the provisions of existing internal revenue laws. Thereafter, and on May 26, 1939, the taxpayer filed a petition for a redetermination of said deficiency by the United States Board of Tax Appeals.

The case was tried before the Board of Tax Appeals on February 26, 1941, at Los Angeles, California.

On February 24, 1942, the Board promulgated its findings of fact and opinion (46 B.T.A. 385), and on April 6, 1942, entered its decision that there is a deficiency in income tax for the year 1935 in the amount of \$63,427.19.

III.

NATURE OF CONTROVERSY

The question involved is whether the sum of \$44,532.22, which was received by taxpayer in 1935 from the escrow agent, and which was attributable to the accumulated dividends which the escrow agent had received in prior [44] years on escrowed stock which was also released to the taxpayer in 1935, constituted ordinary or dividend income in 1935. If received as ordinary income it is subject to the normal tax; if received as dividend income it is not subject to the normal tax since section 25(a)(1) of the Revenue Act of 1934 allows for the purpose of the normal tax only a credit against the net income for "the amount received as dividends from a domestic corporation which is subject to taxation under this title."

The escrowed stock which was delivered to the taxpayer in 1935 consisted of 334 shares of the common stock of United Artists Corporation. Accumulated dividends on this stock in the sum of \$44,532.22 had been paid to the escrow agent in the years 1930, 1931, 1932 and 1934. This stock and accumulated dividends were released to the taxpayer from escrow in 1935.

The Commissioner determined that the fair market value of the 334 shares of common stock of the United Artists Corporation received by the taxpayer in the taxable year 1935 constituted taxable income to him in that year. In this action the Commissioner was upheld by the Board of Tax Appeals, which held that taxpayer became the owner of the 334 shares of stock in 1935 rather than in 1919.

As to the sum of \$44,532.22, the taxpayer treated it as dividends received in 1935 and not subject to the normal tax. The Commissioner treated this sum as ordinary income and subject to the normal tax in determining the deficiency in tax. The Board, however, reversed the [45] Commissioner and held that the amount of \$44,532.22 was "received as dividends from a domestic corporation which is subject to taxation" under Title I of the Revenue Act of 1934 and hence the credit for normal tax, as specified in section 25(a) of such act, should be allowed.

IV.

ASSIGNMENTS OF ERROR

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and

in the opinion and final decision rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Board of Tax Appeals:

The United States Board of Tax Appeals erred:

1. In holding that the sum of \$44,532.22, which was received by taxpayer in 1935 from the escrow agent, and which was attributable to the accumulated dividends which the escrow agent had received in prior years on escrow stock which was also released to the taxpayer in 1935, was "received as dividends from a domestic corporation which is subject to taxation" under Title I of the Revenue Act of 1934 and hence the credit for normal tax, as specified in section 25(a) of such act, should be allowed; and in overruling the Commissioner's determination that this sum constituted ordinary income and was subject to the normal tax. [46]

2. In holding that there is a deficiency in income tax for the year 1935 in the amount of only \$63,427.19.

3. In failing to hold that there is a deficiency in income tax for the year 1935 in the amount of \$65,208.48.

4. In holding that said sum of \$44,532.22 did not lose its character as dividends merely because it

was not delivered to taxpayer in the year declared.

5. In holding that "but if respondent's view be accepted that the amounts set aside in each year were not true dividends, then it would seem that the action of the corporation in the taxable year, making them unconditionally available to petitioner, was tantamount to the declaration and payment by the corporation of a dividend in the aggregate amount of \$44,532.22 upon the 334 shares which petitioner had just received."

6. In failing to hold that the sum of \$44,532.22 received by taxpayer from the escrow agent in 1935 was not received by him as dividends and is not the subject of normal tax credit.

7. In that its opinion and decision are contrary to law.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be [47] prepared in accordance with law and with the rules of said Court and transmitted to the

Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed by said Court.

SAMUEL O. CLARK, JR.,

Assistant Attorney General.

(Signed) J. P WENCHEL

RLW

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

JOHN M. MORAWSKI,

Special Attorney,

Bureau of Internal Revenue.

JMM:mge-6-10-42

[Endorsed]: U.S.B.T.A. Filed Jul. 1, 1942. [48]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR
REVIEW

To: Charles Chaplin, 1416 North LaBrea Avenue,
Los Angeles, California.

You are hereby notified that the Commissioner of Internal Revenue did on the 1st day of July, 1942, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of

the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 1st day of July, 1942.

(Signed) J. P. WENCHEL

RLW

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 4 day of July, 1942.

CHARLES CHAPLIN

Respondent on Review.

[Endorsed]: U.S.B.T.A. Filed Jul. 11, 1942. [49]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR
REVIEW

To: Loyd Wright, Esquire, Herschel B. Green,
Esquire, 1125 Board of Trade Building, Los
Angeles, California.

You are hereby notified that the Commissioner of Internal Revenue did on the 1st day of July, 1942, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for

review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 1st day of July, 1942.

(Signed) J. P. WENCHEL

RLW

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of July, 1942.

LOYD WRIGHT

HERSCHEL B. GREEN

Counsel for Respondent on
Review.

[Endorsed]: U.S.B.T.A. Filed Jul. 11, 1942. [50]

United States Board of Tax Appeals

Docket No. 98795

CHARLES CHAPLIN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

AGREED STIPULATION OF FACTS

The parties hereto, by their undersigned counsel of record, hereby stipulate and agree that the following facts shall be taken as proof upon the filing of this stipulation, subject to the right of either party to introduce other and further evidence not inconsistent with the terms of this stipulation:

I.

The name of the petitioner is Charles Chaplin; his address is 1416 North LaBrea Street, Los Angeles, California. The taxes in controversy are income taxes for the calendar year 1935. The Commissioner asserted a deficiency of \$65,208.48 against petitioner, whereas the petitioner claims an overpayment of \$24,938.04, making a total of [51] \$90,146.52, all of which is in controversy. Petitioner filed his 1935 income tax return with the Collector of Internal Revenue at Los Angeles, California, on March 16, 1936, showing a total tax to be due of \$224,135.58, which was paid to said Collector on the following dates:

March 16, 1936.....	\$ 56,033.90
June 15, 1936.....	56,033.90
September 12, 1936.....	56,033.89
December 15, 1936.....	56,033.89

\$224,135.58

On February 8, 1938, a deficiency of \$7487.89 principal and interest assessed against petitioner for 1935 was paid to said Collector according to agreement.

II.

In 1919, Charles Chaplin, petitioner herein, Douglas Fairbanks, and Mary Pickford, artists, and David W. Griffith, producer, all of whom were favorably known, and their respective names having exceptional trade value in all parts of the world where motion pictures were exploited and exhibited, agreed to associate themselves together in the distribution of the motion pictures thereafter produced by them.

III.

Thereupon, said individuals referred to in paragraph II above, on February 5, 1919, entered into a memorandum of agreement, a copy of which may be received in evidence as [52] petitioner's Exhibit I, which said agreement provided for the formation of United Artists Corporation, the capital stock of which consisted of two classes: (a) 6,000 shares of 8% accumulative preferred stock, par value \$100.00 per share; and (b) 9,000 shares of common stock, no par value.

IV.

Thereafter, on April 17, 1919, the certificate of incorporation of United Artists Corporation was filed with the Secretary of State of the State of Delaware rather than the State of New York as provided in Exhibit I referred to in paragraph III above, a true copy of said certificate of incorporation may be received in evidence as petitioner's Exhibit II, and a true copy of the bylaws of said corporation may be received in evidence as petitioner's Exhibit III.

V.

On June 9, 1919, there was issued in the name of petitioner 1,000 shares of the common stock of United Artists Corporation evidenced by certificates Nos. 19, 20, 21, 22, 23, 24, 25, and 26, for 111 shares each, and certificate #27 for 112 shares, photostatic copies of which may be received in evidence as petitioner's Exhibit IV.

VI.

On February 5, 1919, Charles Chaplin signed a proposed distribution agreement with United Artists [53] Corporation, which said agreement was subsequently executed by United Artists Corporation on June 13, 1919, a copy of which may be received in evidence as petitioner's Exhibit V. Said agreement provides for the producing of nine feature photoplays by the said Charles Chaplin within three years from the date thereof.

VII.

On July 5, 1919, Charles Chaplin, petitioner herein, Douglas Fairbanks, David W. Griffith, and Mary Pickford entered into an agreement with United Artists Corporation amending subdivision (i) of paragraph 3 of each of those certain four contracts dated February 5, 1919, between each of said individuals and said United Artists Corporation, a copy of said agreement may be received in evidence as petitioner's Exhibit VI. Said agreements of July 5, 1919, provided for the issuance of said 1,000 shares of common stock in the names of said individuals in the form of nine certificates, eight of which were to be each in the sum of 111 shares, and one of which was to be for 112 shares, and upon the delivery by each of said individuals of the first eight photoplays called for under his contract, such escrow agent was to deliver to the said individual one of said certificates for 111 shares for each photoplay delivered, and upon the delivery by the said individual of the ninth photoplay called for, said escrow agent was to deliver to said individual said certificate for 112 shares. [54]

VIII.

On August 5, 1919, United Artists Corporation, Charles Chaplin, and Dennis F. O'Brien entered into an escrow agreement wherein it was provided that there should be deposited with the said Dennis F. O'Brien, as escrow holder, the certificates of

stock evidencing 1,000 shares of common stock of United Artists Corporation issued in the name of Charles Chaplin, and more particularly described in paragraph V hereof. A copy of said agreement may be received in evidence as petitioner's Exhibit VII.

IX.

On November 22, 1942, Charles Chaplin, petitioner herein, Mary Pickford Fairbanks, Douglas Fairbanks, Joseph M. Schenck, and United Artists Corporation, entered into an agreement, a true copy of which may be received in evidence as petitioner's Exhibit VIII. Said agreement modifies the distribution agreement between Charles Chaplin and United Artists Corporation dated February 5, 1919 by providing that Charles Chaplin shall be obligated to deliver to the corporation for distribution only five additional motion picture photoplays described in the original contract instead of the eight undelivered pictures provided for in said contract. Said agreement further provides that the balance of the common stock of the corporation held in escrow for the benefit of Charles Chaplin shall be delivered to him in the proportion [55] of one-fifth thereof upon the delivery of each motion picture photoplay by Charles Chaplin to United Artists Corporation. Said agreement further provides that Charles Chaplin shall deliver to said corporation one motion picture photoplay per year commencing at the date thereof.

X.

On October 31, 1928, Charles Chaplin delivered to United Artists Corporation a certificate for 111 shares of common stock of said corporation which was released from escrow to him upon the delivery to said corporation of the motion picture photoplay *A Woman of Paris*, and at said time the 889 shares still held in escrow by Dennis F. O'Brien were delivered to United Artists Corporation for cancellation. Said certificates of stock were cancelled, and on said date there was issued by said corporation in the name of said Charles Chaplin the following certificates of common stock: #83 for 166 shares; #84 for 167 shares; #85 for 166 shares; #86 for 167 shares; #87 for 167 shares; and #88 for 167 shares, a total of 1,000 shares. Photostatic copies of the aforesaid certificates of stock may be received in evidence as petitioner's Exhibit IX. All of the foregoing certificates were placed in escrow with Dennis F. O'Brien pursuant to the agreement dated February 5, 1919. Thereafter on November 8, 1928, there was released from said escrow and delivered to Charles Chaplin certificates #83 for 166 shares; #84 for 167 shares, and #85 for 166 shares of said common stock. [56]

XI.

On February 27, 1931, certificate #86 for 167 shares of no par common stock of United Artists Corporation was released from escrow and delivered to Charles Chaplin upon completion of the picture

City Lights pursuant to the terms of the agreement dated February 5, 1919 as amended on November 22, 1924.

XII.

On September 20, 1935, an agreement was entered into between United Artists Corporation and Charles Chaplin, a copy of which may be received in evidence as petitioner's Exhibit X, under which there was released to the said Charles Chaplin from escrow certificates #87 and #88 each for 167 shares of the common stock of United Artists Corporation, with accumulated dividends thereon in the sum of \$44,532.22, which was the balance of the common stock held in escrow for the said Charles Chaplin.

XIII.

The accumulated dividends on the 334 shares of stock evidenced by certificates #87 and #88, referred to in paragraph XII, were paid to the escrow agent in the following years: [57]

1930.....	\$ 6,680.00
1931.....	3,340.00
1932.....	3,340.00
1934.....	31,172.22
	<hr/>
	\$44,532.22

(s) LOYD WRIGHT

(s) HERSCHEL B. GREEN

Counsel for Petitioner

(s) J. P. WENCHEL

BH

Counsel for Respondent [58]

[Title of Board and Cause.]

United States Post Office and Court House,
Los Angeles, California

February 26, 1941.

10:00 o'Clock a. m.

Before: Hon. Arthur J. Mellott.

Met pursuant to notice.

APPEARANCES:

Hershel B. Green and Loyd Wright, 1125
Board of Trade Building, Los Angeles,
California, and J. R. White, 530 West 6th
Street, Los Angeles, California, appearing
for Charles Chaplin, the Petitioner.

Byron M. Coon and Frank T. Horner, appear-
ing for the Commissioner of Internal Rev-
enue, Respondent. [60]

PROCEEDINGS

The Clerk: 98795, Charles Chaplin. State your
appearances, please.

Mr. Green: Loyd Wright and Hershel B. Green
and J. R. White, for the Petitioner.

Mr. Horner: Frank T. Horner for the Respond-
ent, and Mr. B. M. Coon.

The Court: State your case for the Petitioner.

Mr. Green: If the Court please, we have a par-
tial agreed stipulation of facts that I would like
to introduce at this time.

The Court: It may be handed to the Clerk and
will be filed as part of the record.

Mr. Green: In conformity with the stipulation, if the Court please, I have here a number of exhibits that I would like to offer in evidence at this time.

The Court: Very well. Identify them briefly for the record, and the Clerk will give them a number.

Mr. Green: The first is a memorandum of agreement dated February 5, 1919 entered into between Charles Chaplin, who is the Petitioner herein, Douglas Fairbanks, David W. Griffith, and Gladys Mary Moore, which we would like to offer as Petitioner's Exhibit 1.

Mr. Horner: No objection.

The Court: There being no objection, the document will [61] be received as Petitioner's Exhibit No. 1.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 1, and made a part of this record.)

PETITIONER'S EXHIBIT No. 1

Memorandum of Agreement, made and entered into in four copies, each copy to be considered for all purposes as an original, on this 5th day of February, 1919, by and between Charles Chaplin, hereinafter designated as Mr. Chaplin party of the first part, and Douglas Fairbanks, hereinafter designated as Mr. Fairbanks, party of the second part, and

Petitioner's Exhibit No. 1 (Continued)

David W. Griffith, hereinafter designated as Mr. Griffith, party of the third part, and Gladys Mary Moore, professionally known as Mary Pickford, hereinafter designated as Miss Pickford, party of the fourth part; all of the above persons being now present in the City of Los Angeles and the County of Los Angeles, State of California,

WITNESSETH:

Whereas, all of the above named persons are well and favorably known and their respective names have exceptional trade value in all parts of the world where motion pictures in which they have respectively been identified, have been exploited and exhibited, and

Whereas, they have heretofore acted together because of a threatened combination of motion picture stars and producers being formed which, in their opinion, would tend to force upon the theatre-going public, mediocre productions and machine made entertainment and would defeat competition in the motion picture industry; and

Whereas, they desire, in furtherance of the artistic welfare of the moving picture industry and to better serve the great and growing interest in motion picture productions, to become associated in the distribution of the motion pictures produced by them as more fully hereinafter set forth for exhibition purposes.

Now, Therefore, in consideration of the premises

Petitioner's Exhibit No. 1 (Continued)

and of the mutual promises and covenants herein set forth and the further consideration of the sum of One (\$1.00) Dollar each to all the others in hand paid, the receipt of which is hereby individually and respectively acknowledged by all of the parties hereto, each and all of the parties hereto agree with each other and all the others as follows:

FIRST:

All of the above named persons do hereby agree and by these presents have agreed to become associated with each other and with all the others in the exploiting, marketing, distributing and turning to account the motion pictures produced by them as more particularly hereinafter described, pursuant to the terms, conditions and provisions herein set forth:

The above named persons agree to organize or cause to be organized a corporation pursuant to the laws of the State of New York, the details of such corporation to be as follows:

(1) The name of said corporation shall be United Artists Corporation.

(2) The capital stock of said corporation shall consist of two classes:

(Class A) Eight percent accumulative preferred stock in the amount of six thousand (6,000) shares, the subscription price of which is to be One Hundred (\$100.00) Dollars per share, or such other price as the Board of Directors of said corporation may from time to time determine, the same to

Petitioner's Exhibit No. 1 (Continued)

be non-voting stock and to be subject to the right of redemption upon call by the Board of Directors in whole or in part at 105% of par. It is contemplated that one-third the preferred stock shall be redeemed at the end of each year from the earnings of the corporation and that in case the earnings are not sufficient to redeem such one-third in any year the deficiency shall be made up in the next subsequent year, but that not more than one-third plus such deficiency shall be redeemed in any year.

(Class B) Common stock in the amount of nine thousand (9,000) shares of no par value to be issued and paid for in the following manner:

One thousand (1,000) shares to each of the above named persons in part consideration of the execution and fulfillment of the contract pertaining to the exploiting, marketing, distributing and turning to account of his or her motion pictures with the said corporation. The details concerning the delivery of the aforesaid common shares of stock to each of the aforesaid persons shall be more fully set forth in the agreement between said person and said corporation pertaining to the exploiting, marketing, distributing and turning to account the motion pictures produced by such person and included in such contract.

One thousand (1,000) shares to William G. McAdoo who is to become the General Counsel of said corporation.

All of the aforesaid common stock shall be issued subject to the right of the said corporation for its

Petitioner's Exhibit No. 1 (Continued)

then existing stockholders to purchase the same in the event of such stockholder desiring to sell any portion or all of his or her shares of common stock in said corporation to any person who is now actively associated with such stockholder in the business of producing photoplays, and each certificate of common stock shall have written or printed on its face a notice of such prior rights of repurchase. Conditions governing such right or repurchase shall be fully set forth in the by-laws of the said corporation and a copy of the same shall be attached to each certificate of common stock of said corporation.

Voting: The owner of the said common stock shall be entitled to one vote for each share of stock owned by him or her and the election of the members of the Board of Directors of said corporation shall be accumulative voting meaning and intending that the owners of the common stock may cast the number of votes that he or she is entitled to by virtue of the number of shares of stock he or she may own, multiplied by the number of directors to be elected at the given election in which the stockholders are then voting, for one Director if he or she so elect; or the owners of such common stock may cast the votes that he or she may be entitled to for the election of such persons as he or she may desire as Director.

Directors: The Board of Directors of said corporation shall be five; it being the intention of the parties hereto that each of said parties have the

Petitioner's Exhibit No. 1 (Continued)

privilege of being represented by one Director on such Board of Directors. The number of Board of Directors may be increased or diminished in pursuance of the laws governing same.

The duration of the corporation shall be perpetual.

The purposes for which the corporation shall be organized shall be the motion picture business and business incidental thereto and such other business as the Board of Directors may from time to time determine.

It is understood that the plan outlined in this agreement will be translated into legal form by Mr. McAdoo as general counsel for the corporation, in such manner as he may determine to be legally advisable and that the parties will, under his guidance, take such steps in the formation of the corporation, and will execute such supplementary contracts and documents for the purpose of effectuating his agreement, as he may deem advisable.

SECOND

FINANCING OF THE CORPORATION

Each of the parties hereto agree with each other and all the others, and with said corporation and for the benefit of said corporation, to subscribe and by these presents has subscribed, for the purchase of One Thousand (1,000) Shares of said preferred stock of the corporation for the sum of One Hundred (\$100.00) Dollars per share, totaling One Hun-

Petitioner's Exhibit No. 1 (Continued)

dred Thousand (\$100,000.00) Dollars, to be paid for when called by written notice to that effect by said Mr. McAdoo; each call not to exceed twenty (20%) per cent of said subscription and such calls to be at least thirty (30) days apart. Such subscriptions are to be paid to said Mr. McAdoo as trustee prior to the incorporation of said corporation, thereafter to the treasurer of the corporation.

Upon the payment of each subscription the subscriber who has so paid his subscription, shall be entitled to receive the number of shares of said preferred stock that he will have paid for, such certificates of such stock to be delivered to the subscriber after the corporation has been organized.

The parties hereto agree that the above subscriptions shall inure to and be for the benefit of said corporation as fully as if said corporation were now legally organized and such subscription were legally made directly with said corporation; and for the purpose of completing and carrying out the aforesaid subscription, each of the parties hereto does hereby designate and by these presents has designated the said Mr. McAdoo as his attorney in fact, for him and for her individually and severally, with full power and authority to transfer, set over and assign his or her above subscription for the purchase of said preferred stock of said corporation to said corporation as soon as organized, hereby confirming and ratifying the acts of said Mr. McAdoo in the making of such assignment.

Petitioner's Exhibit No. 1 (Continued)

THIRD

CONTRACT FOR DISTRIBUTION OF
MOTION PICTURES

Each of the parties hereto agrees with each other and with all the others and with the said corporation when organized, and for the benefit of said corporation and for the benefit of all the parties hereto, to execute and deliver a contract with said corporation for the sole and exclusive license to market, exploit, distribute and turn to account the motion pictures that each shall produce for and during the period specified in such contract between said corporation and each of said parties to this contract, and for the particular motion pictures described in said contract, and pursuant to all the terms, conditions and provisions set forth in such contract, and for that purpose each of the parties hereto does execute and deliver contemporaneously with the execution and delivery of this agreement, the aforesaid so-termed Distribution Contract with said corporation fully executed on the part of such person to said Mr. McAdoo, and does hereby direct and empower said Mr. McAdoo to procure forthwith upon the organization of said corporation the execution of said contract in duplicate by said corporation and to deliver one of each of said duplicate originals of said contract to each of the parties to said contract, hereby ratifying and confirming the act of said Mr. McAdoo in so doing. All of the parties hereto do hereby agree to cause the

Petitioner's Exhibit No. 1 (Continued)

Board of Directors of said corporation to authorize the proper officials of said corporation to execute the aforesaid Distribution Contracts in behalf of said corporation with each of the parties hereto.

FOURTH

RESPONSIBILITY OF PERSONS

The parties hereto do hereby agree and by these presents have agreed that this agreement does not, and is not intended to constitute a copartnership between them, but is to serve as the basis upon which their business relations incident to the enterprise herein described are predicated; and the organization of the corporation and the execution and delivery of the Distribution Contracts and the fulfillment of the terms and provisions of this agreement, shall supersede this contract, and nothing contained herein shall abridge the powers of the Board of Directors of said corporation or control its deliberative action. Should any conflict arise between the provisions of this agreement and any subsequent or superseding agreements, the language in the subsequent or superseding agreements shall control. The parties hereto agree that this instrument shall be construed and enforced pursuant to the laws of the State of New York.

The parties hereto agree that in the event that Mr. McAdoo refuses or fails to act in the capacity herein designated, that all of the power and authority granted to him by each of the parties here-

Petitioner's Exhibit No. 1 (Continued)

to are granted to such other person as may be selected in writing by a majority of the parties hereto, such person to have the same power and authority as hereinbefore provided for the said Mr. McAdoo.

This contract is binding upon the parties hereto, their respective heirs, legal representatives and assigns.

In Witness Whereof, the parties hereto have hereunto subscribed their names and affixed their seals the day and year first above written.

In the presence of:

CHARLES CHAPLIN (L.S.)

DOUGLAS FAIRBANKS (L.S.)

D. W. GRIFFITH (L.S.)

GLADYS MARY MOORE (L.S.)

Known as Mary Pickford

State of California,
County of Los Angeles—ss.

On this 5th day of February, 1919, before me, Arthur Wright, a Notary Public in and for said County, residing therein, duly commissioned and sworn, personally appeared Charles Chaplin, known to me to be the person whose name is subscribed to the within agreement, and acknowledged to me that he executed the same.

Witness my hand and official seal.

ARTHUR WRIGHT

Notary Public in and for said County of Los Angeles, State of California.

Petitioner's Exhibit No. 1 (Continued)

State of California,
County of Los Angeles—ss.

On this 5th day of February, 1919, before me, Arthur Wright, a Notary Public in and for said County, residing therein, duly commissioned and sworn, personally appeared Douglas Fairbanks, known to me to be the person whose name is subscribed to the within agreement, and acknowledged to me that he executed the same.

Witness my hand and official seal.

ARTHUR WRIGHT,

Notary Public in and for said County of Los Angeles, State of California.

State of California,
County of Los Angeles—ss.

On this 5th day of February, 1919, before me, Arthur Wright, a Notary Public in and for said County, residing therein, duly commissioned and sworn, personally appeared David W. Griffith, known to me to be the person whose name is subscribed to the within agreement, and acknowledged to me that he executed the same.

Witness my hand and official seal.

ARTHUR WRIGHT

Notary Public in and for said County of Los Angeles, State of California.

Petitioner's Exhibit No. 1 (Continued)
State of California,
County of Los Angeles—ss.

On this 5th day of February, 1919, before me, Arthur Wright, a Notary Public in and for said County, residing therein, duly commissioned and sworn, personally appeared Gladys Mary Moore, professionally known as Mary Pickford, known to me to be the person whose name is subscribed to the within agreement, and acknowledged to me that she executed the same.

Witness my hand and official seal.

ARTHUR WRIGHT,
Notary Public in and for said County of Los Angeles, State of California.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The second is a conformed copy of the certificate of incorporation of United Artists Corporation, which I would like to offer as Petitioner's Exhibit 2.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 2, and made a part of this record.)

PETITIONER'S EXHIBIT No. 2

CERTIFICATE OF INCORPORATION OF
UNITED ARTISTS CORPORATION

First: The name of the corporation is United Artists Corporation.

Second: The location of its principal office in the State of Delaware is No. 7 West 10th Street, in the City of Wilmington, County of New Castle. The name of the agent therein and in charge thereof is the Corporation Trust Company of America, No. 7 West 10th Street, Wilmington, Delaware.

Third: The nature of the business or objects or purposes proposed to be transacted, promoted or carried on are:

(a) To acquire, produce, create, sell, lease, market or dispose of pictures, plays and photoplays, and any and all rights and interests therein or in regard thereto and all other articles connected therewith or incidental thereto.

(b) To improve the photoplay industry and its artistic standards, and the methods of marketing photoplays.

(c) To market photoplays in the interest of the artists who create them.

(d) To manufacture, purchase or otherwise acquire, to hold, own, mortgage, pledge, sell, assign and transfer, or otherwise dispose of, to invest, trade, deal in and deal with goods, wares, merchandise, interests, rights, patent rights, copyrights, and real and personal property of every class and description.

(e) To acquire the good-will, rights and property, and to take over the whole or any part of the assets and liabilities, of any person, firm, association or corporation and to pay for the same in cash, stocks or bonds of this corporation, or otherwise.

(f) To enter into, make, perform and carry out contracts of every kind, for any lawful purpose, without limits as to amount, with any person, firm, association or corporation.

(g) To have one or more offices, to carry on all or any of its operations and business without restriction or limit as to amount to purchase, or otherwise, acquire, to hold, own, to mortgage, sell, convey or otherwise dispose of real and personal property of every class and description in any of the states, districts, territories or colonies of the United States, and in any and all foreign countries, in accordance with the law thereof.

(h) In general, to carry on any other business in connection with the foregoing, whether manufacturing or otherwise, and to have and to exercise all the powers conferred by the laws of Delaware and upon corporations formed under the act hereinafter referred to.

Fourth: The total number of shares authorized to be issued by the corporation is fourteen thousand. Out of the total number of shares, five thousand shall be preferred shares. The preferred shares shall have a par value of one hundred dollars each.

The holders of the preferred shares shall be entitled to receive annual dividends at the rate of

eight per cent. per annum and no more out of the surplus profits of the corporation quarter-yearly, payable on the first days of February, May, August and November in each year. Such dividends shall be cumulative and all accrued dividends and arrears of dividend on the preferred shares shall be paid before any dividends shall be paid or set apart for the common shares.

The whole, or for the purposes of any sinking fund provided herein and in the by-laws any part, of the preferred shares may, at the option of the Board of Directors, be redeemed on any quarterly dividend payment date, by paying therefor in cash, at the time fixed for such redemption, one hundred and five dollars (\$105) per share and all accumulated unpaid and accrued dividends thereon, on such notice and in such manner as may be provided in the by-laws. In case preferred shares called for redemption are not duly presented for redemption, they shall cease to be entitled to share in further or later dividends.

On or before the first day of May, 1920, and on or before the first day of May in each year thereafter, until all of the preferred shares shall have been redeemed, there shall be set apart out of the remaining surplus profits of the corporation after all accumulated and defaulted dividends upon the preferred shares shall have been paid, or set apart and provided for an amount equal to (1) one-third of the total par value of all the then outstanding preferred shares of the corporation, plus (2) five per cent. of such total par value.

The amount thus ascertained shall on each May first then be paid and credited to a sinking fund.

The moneys in the sinking fund on each May first shall be used and applied in redemption of preferred shares, on or before the next following August first.

Whenever, for the purpose of the sinking fund, less than the whole amount of the preferred shares then outstanding is to be redeemed, the particular shares to be redeemed shall be ascertained in such manner as the by-laws shall prescribe. Such redemption shall be equal among all the shareholders, excepting that in calling the preferred shares for redemption, no resultant fractions of shares shall be called for redemption.

Any deficiency in the amount required to be set apart in any year to the credit of the sinking fund, as provided in this article, shall in the next succeeding year be added to the sinking fund out of the surplus profits of this corporation.

In no event shall any dividends be declared or paid on the common shares until (1) the current quarterly dividend on the preferred shares as well as all accumulated and accrued dividends thereon shall have been paid and set apart; and (2) all arrears, if any, in respect to any amounts hereinbefore required to have been set apart and credited to the sinking fund shall have been made good.

Subject to the foregoing provisions such dividends as may be determined by the Board of Directors may be declared and paid on the common

shares of the corporation from time to time out of the outstanding surplus profits of the corporation.

In the event of insolvency or merger or consolidation of the corporation, or voluntary or involuntary dissolution, or bankruptcy or liquidation of the corporation, or sale of all its assets, there shall be paid to the holders of the preferred shares then outstanding, one hundred dollars (\$100.) per share and all accumulated unpaid and accrued dividends thereon, before any sums shall be paid to or any assets distributed among the holders of the common shares; and after such payments to the holders of the preferred shares all remaining assets or funds of the corporation shall be divided among and paid to the holders of the common shares according to their respective holdings.

The preferred shares shall have no voting rights.

At all elections of directors of the Corporation each holder of shares (as to which he is entitled to vote as herein stated) shall be entitled to as many votes as shall equal the number of his shares multiplied by the number of directors to be elected; he may cast all of such votes for a single director or may distribute them among the number to be voted for or any two or more of them, as he may see fit. This right when exercised shall be termed cumulative voting.

No shareholder or holder of obligations of the corporation convertible into shares shall be entitled as of right to subscribe for, acquire or receive any

part of any further additional issue of shares or obligations of the corporation convertible into shares but such further issue may be disposed of by the Board of Directors to such persons and on such terms and (so far as permitted by law) for such consideration as the Board in their absolute discretion may deem advisable.

The Board of Directors may at the time of original issue of any shares of the corporation prescribe such limitations of transferability of such shares or any of them as in their discretion they may deem advisable; provided that such limitations conform to the by-laws of the corporation and that the certificate evidencing the ownership of such shares bear upon its face reference to such limitation of transferability.

The Corporation may at any meeting of its Board of Directors sell, lease or exchange all of its property and assets, including its good-will and its corporate franchises, upon such terms and conditions as its Board of Directors deem expedient and for the best interests of the Corporation, but only when and as authorized by the affirmative vote of the holders of three-fourths of the shares issued and outstanding having voting powers given at a shareholders' meeting duly called for that purpose, or when authorized by the written consent of the holders of three-fourths of the voting shares issued and outstanding.

In addition to the preferred shares above described, the number of shares authorized to be

issued by the corporation is nine thousand, all of which additional shares shall be common shares without par value.

Fifth: The number of shares with which this corporation will commence business is ten preferred shares, and ten common shares of no par value.

Sixth: The names and places of residence of the original subscribers to the capital stock and the number of shares subscribed for by each are as follows:

Name	Residence	Number of Shares	
		Pref.	Common
T. L. Croteau	Wilmington, Del.	8	8
P. B. Drew,	Wilmington, Del.	1	1
M. M. Clancy,	Wilmington, Del.	1	1

Seventh: This corporation is to have perpetual existence.

Eighth: The private property of the shareholders shall not be subject to the payment of corporate debts to any extent whatever.

Ninth: In furtherance and not in limitation of the powers conferred by statute, the board of directors are expressly authorized:

To fix the amount to be reserved as working capital, to authorize and cause to be executed mortgages and liens upon any real and personal property of this corporation.

The corporation reserves the right to amend, alter, change or repeal any provision contained in this certificate of incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred on shareholders herein are granted subject to this reservation.

We, the Undersigned, being each of the original subscribers to the capital stock hereinbefore named, for the purpose of forming a corporation to do business both within and without the State of Delaware, and in pursuance of an Act of the Legislature of the State of Delaware entitled "An Act Providing a General Corporation Law" (approved March 10th, 1899), and the acts amendatory thereof and supplemental thereto, do make and file this certificate, hereby declaring and certifying that the facts herein stated are true, and do respectively agree to take the number of shares of stock hereinbefore set forth, and accordingly have hereunto set our hands and seals this 17th day of April, A. D., 1919.

In the presence of:

HERBERT E. LETTER

T. L. CROTEAU (Seal)

P. B. DREW (Seal)

M. M. CLANCY (Seal)

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: No. 3 is a conformed copy of the bylaws of the United Artists Corporation, which we would like to offer as Petitioner's Exhibit No. 3.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 3, and made a part of this record.)

PETITIONER'S EXHIBIT No. 3

(Copy)

BY-LAWS
OF
UNITED ARTISTS CORPORATION

ARTICLE I.

Seal.

The Board of Directors (herein sometimes called the Board) shall provide a suitable seal for the corporation which shall remain in the custody of the Secretary. It shall be affixed to all certificates of the shares and to other instruments requiring a seal. A duplicate seal may be kept and, when authorized by the Board, used by any other officer of the corporation.

ARTICLE II.

Shares.

Section 1. Certificates. Certificates evidencing the ownership of the preferred and common shares

Petitioner's Exhibit No. 3 (Continued)

of the corporation of such tenor and design as the Board may from time to time adopt shall be issued to those entitled to them. Each certificate for preferred shares and each certificate for common shares shall bear a distinguishing number, the signature of the President or Vice-President and of the Secretary or of the Treasurer, the seal of the corporation and such recitals as may be required by law. The certificates for the preferred and common shares shall be issued respectively in numerical order and a full record of the issue of each certificate shall be made in the books.

Section 2. Transfers. The shares may be transferred on the books of the corporation by the registered holders thereof or by their attorneys legally constituted or their legal representatives by surrender of the certificates therefor for cancellation and a written assignment of the shares evidenced thereby. The Board may from time to time appoint such Transfer Agents or Registrars of shares as it may deem advisable and may define their powers and duties.

Section 3. Lost Certificates. The Board may order a new certificate or certificates of shares to *be issued in place of any certificate or certificates of shares* to be issued in place of any certificate or certificates alleged to have been lost or destroyed, but in every such case the owner of the lost certificate or certificates may be required to give the corporation a bond, with surety or sureties satisfactory to the corporation, in such sum as the Board

Petitioner's Exhibit No. 3 (Continued)

may deem sufficient, as indemnity against loss or liability; but the Board may in its discretion refuse to issue such new certificates save upon the order of some court having jurisdiction in such matters.

Section 4. Closing of Transfer Books. The share transfer books of the corporation may be closed by order of the Board for a period not exceeding ten days prior to any meeting of the shareholders, and for a period not exceeding ten days prior to the payment of any dividend. The times during which the books may be so closed shall from time to time be fixed by the Board.

Section 5. Dividends. The Board may declare dividends from the surplus or net profits arising from the business of the Corporation. Dividends may be declared, subject to the provisions of the Certificate of Incorporation, upon the preferred shares and upon the common shares of the Corporation, in the months of January, April, July and October in each year, prior to the fifteenth day of said months respectively, at any annual, regular or special meeting of the Board, or on the days to which any such meetings may be adjourned, at which times the Board, in its discretion, subject to the provisions of the Certificate of Incorporation, shall determine what, if any, dividends shall be declared. Dividends on the preferred and common shares, if declared, severally and respectively, shall be payable on the first days of February, May, August and November next after the several

Petitioner's Exhibit No. 3 (Continued)

dates of the declaration thereof, and shall be payable to the stockholders of record at the close of business on the fifteenth of the month in which they shall have been declared. If any date herein appointed for the payment of any dividend, or herein fixed for determining the shareholders of record, to whom the same is payable, shall, in any year, fall upon a Sunday or legal holiday, then such dividend shall be payable, or such shareholders of record shall be determined, on the next succeeding day not a Sunday or legal holiday.

ARTICLE III.

Shareholders' Meetings.

Section 1. Annual meeting. The annual meeting of the shareholders of the corporation shall, beginning with the year 1920, be held in each year at the principal business office of the corporation, which may be established outside of the State of Delaware (or at such other place within or without the State of Delaware as the Board may determine) at 3 o'clock in the afternoon on the first Monday in April (or if said day be a legal holiday, then on the next succeeding day not a holiday), for the purpose of electing Directors and Officers and for the transaction of such other business as may be brought before the meeting.

Section 2. Special Meetings. Special meetings of the shareholders must be called by the Secretary upon written request of the President or of any

Petitioner's Exhibit No. 3 (Continued)

director. No business other than that specified in the call therefor shall be considered at any special meeting. Special meetings shall be held at the principal business office of the corporation outside the State of Delaware unless the Board shall name another place therefor.

Section 3. Notice. Notice of the annual meeting shall, at least ten days prior to the date thereof, be mailed to each shareholder of shares entitled to voting rights at his last known post-office address as the same appears on the records of the Corporation.

Notice of each special meeting stating the purpose thereof shall be mailed at least ten days prior to the date thereof to each shareholder at his last known post-office address as the same appears on the records of the corporation.

Section 4. Quorum. A majority in amount of the shares authorized by the Certificate of Incorporation to vote, issued and outstanding represented by the holders of record thereof in person or by proxy shall be requisite to constitute a quorum at any meeting of shareholders; but less than such majority may adjourn the meeting from time to time, and at any such adjourned meeting any business may be transacted which might have been transacted if the meeting had been held as originally called.

Section 5. Proxies. Any shareholder entitled to a vote at a meeting of the shareholders may be represented and vote thereat by proxy, appointed

Petitioner's Exhibit No. 3 (Continued)

by an instrument in writing subscribed by such shareholder or by his duly authorized attorney and submitted to the Secretary at or before such meeting.

Section 6. Election of Directors. The election of Directors may be conducted by two inspectors of election appointed after the first election by the President or a Vice-President. The vote in elections of Directors and, upon demand of a shareholder present in person or by proxy, the vote on any question shall be by share vote and by ballot.

Section 7. Order of Business. At all meetings of the shareholders the order of business shall be as follows:

(a) Call to order.

(b) Election of a Chairman and the appointment of a Secretary, if necessary.

(c) Presentation of proofs of the due calling of the meeting—the certificate of the Secretary or affidavit of other person who mailed the notice shall be conclusive of service.

(d) Presentation and examination of proxies.

(e) Reading and settlement of the minutes of the previous meeting.

(f) Reports of officers and committees.

(g) If the annual meeting, or a meeting called for that purpose, the election of Directors and Officers.

(h) Unfinished business.

(i) New Business.

(j) Adjournment.

Petitioner's Exhibit No. 3 (Continued)

ARTICLE IV.

Directors.

Section 1. Terms of Office. The directors of the corporation shall hold office until the annual meeting of the shareholders succeeding their appointment or election, and thereafter until their respective successors shall have been duly elected and qualified.

Section 2. Powers. All the powers of the corporation are vested in and shall be exercised by the Board except as otherwise prescribed by statute, or by the certificate of incorporation or by these by-laws.

Section 3. Vacancies. A resignation from the Board of Directors shall be deemed to take effect upon its receipt by the Secretary unless some other time is specified therein. In case of any vacancy in the Board, through death, resignation, disqualification or other cause deemed sufficient by the Board, the remaining Directors, by affirmative vote of a majority of those present at any duly convened meeting, may elect a successor to hold office for the unexpired portion of the term of the Director whose place shall be vacant and until the election and qualification of a successor. Should the membership of the Board at any time become below the number necessary to constitute a quorum, then a special meeting of the shareholders shall be called forthwith and so many directors be elected thereat as may be necessary to bring the Board to its full membership.

Petitioner's Exhibit No. 3 (Continued)

Section 4. Election of Officers. At the first meeting of the Board in each year (at which a quorum shall be present) held next after the annual meeting of the shareholders, the Board shall appoint such officers and employes, not chosen by the shareholders, as it shall determine (provided that the shareholders may, if they deem it expedient, themselves elect or remove any or all officers and employes at any general or special meeting).

Section 5. Regular Meetings. Regular meetings of the Board shall be held on such dates as the Board may designate.

Section 6. Special Meetings. Special meetings of the Board of Directors shall be called by the Secretary and held at the request of the President or of any Director.

Section 7. Notice of Meetings. The Secretary shall give notice of each meeting of the Board whether regular or special to each member of the Board by mail or telegraph to his last known post-office address. Such notice shall be given by mailing the same two days before the meeting or by telegram sent one day before the meeting.

Section 8. Quorum. A majority of the Board shall constitute a quorum at all meetings thereof.

Section 9. Place of Meeting. The Board may hold its meetings at such place or places within or without the State of Delaware as the Board may from time to time determine.

Petitioner's Exhibit No. 3 (Continued)

Section 10. Compensation. Directors, as such, shall not receive any stated salary for their services, but, by resolution of the Board, a fixed sum and expenses of attendance, if any, may be allowed for attendance at each regular or special meeting; provided, that nothing herein contained shall be construed to preclude any Director from serving the corporation in any other capacity and receiving compensation or commissions therefor. Members of either standing or special committees may be allowed such compensation as the Board may determine.

Section 11. Inspection of Books. The Board shall, subject to the Certificate of Incorporation and to the law of the State of Delaware, determine the conditions and regulations under which the books and accounts of the corporation or any of them shall be opened to the inspection of shareholders.

Section 12. Offices and Books Outside State. The Board may from time to time establish corporate offices and agencies and keep the books of the corporation at such place or places outside the State of Delaware as they may from time to time designate.

ARTICLE V.

Officers.

Section 1. Officers. The officers of the corporation shall be a president, a vice-president, a treasurer and a secretary, who shall be elected by share-

Petitioner's Exhibit No. 3 (Continued)

holders (but if said officers are not elected by the shareholders, then they shall be elected by the Board) to serve for one year and until their respective successors are elected and qualified. The president shall be a member of the Board. Additional vice-presidents may be elected from time to time for such terms as determined by the Board which may also appoint one or more assistant secretaries and one or more assistant treasurers, a general manager and such subordinate officers and agents of the corporation as it may from time to time determine.

Section 2. President. The President shall preside at all meetings of the shareholders, unless the shareholders shall appoint a Chairman (who may be the President) and the President shall also preside at all meetings of the Board. He shall exercise, subject to the control of the Board, a general supervision over the affairs of the corporation, and shall perform such other duties as may be assigned to him from time to time by the Board.

Section 3. General Manager. The General Manager shall perform such duties as may be assigned to him by the Board.

Section 4. Vice-President. The Vice-President or Vice-Presidents shall perform the duties of the President in his absence or during his inability to act. The Vice-Presidents shall also have such other and further powers and shall perform such other and further duties as may be assigned to them by the Board.

Petitioner's Exhibit No. 3 (Continued)

Section 5. Treasurer. The Treasurer shall have the custody of the funds and securities of the corporation which may come into his hands. When necessary or proper, he may endorse on behalf of the corporation, for collection, checks, notes and other obligations. He shall deposit the funds of the corporation to its credit in such hands and depositaries as the Board may from time to time designate. He shall submit to the annual meeting of shareholders a statement of the financial condition of the corporation, and whenever thereunto required by the Board, shall make and render a statement of his accounts and such other statement as may be required. He shall keep in books of the corporation full and accurate account of all moneys received and paid by him for account of the corporation. He shall perform such other duties as may be from time to time assigned to him by the Board. The Treasurer shall give bond for the faithful performance of his duties. Such bond check shall be in the sum of \$50,000, executed by a surety company approved by the Board.

Section 6. Secretary. The Secretary shall keep the minutes of all meetings of the Board, and of the shareholders, unless another person be appointed for that purpose by the shareholders, in books, provided for that purpose. He shall give or cause to be given all notices required by these By-Laws or by resolution of the Board. He shall have charge of the share certificate book, share

Petitioner's Exhibit No. 3 (Continued)

transfer books and share ledgers, all of which shall at all reasonable hours be open to the examination of any Director; he shall have custody of the seal of the corporation; and he shall in general perform all the duties usually incident to the office of secretary, subject to the control of the Board.

Section 7. Assistant Officers. The Assistant Secretary or Secretaries and the Assistant Treasurer or Treasurers shall perform the duties of the Secretary and of the Treasurer, respectively, in the absence of those officers and shall have such further powers and perform such other duties as may be assigned to them respectively by the Board.

Section 8. Removal. Any person elected to office by the Board may be removed at any time upon vote of the majority of Directors in office at any meeting specially called for the consideration of such removal.

ARTICLE VI.

Signatures.

Section 1. Negotiable Instruments. All checks, drafts, notes or other obligations of the corporation shall be signed by the following officers, to wit: President or Vice-President and Treasurer, or by any person or persons thereunto authorized by the Board.

Section 2. Share Transfers. All endorsements, assignments, transfers, powers or other instruments of transfer of securities standing in the name of the corporation by any two of the following officers,

Petitioner's Exhibit No. 3 (Continued)

to wit: The President or a Vice-President, the Treasurer, and the Secretary; or by any person or persons thereunto authorized by the Board.

ARTICLE VII.

Redemption and Transferability of Shares.

Whenever for the purposes of the sinking fund described in the certificate of incorporation less than the whole amount of the preferred shares is to be redeemed, the particular shares to be redeemed shall be ascertained as follows: Forthwith, after the setting apart of moneys for the sinking fund on any May first, the Secretary shall determine the number of preferred shares which the funds then in the sinking fund shall be sufficient to redeem at the rate stated in the certificate of incorporation for such redemption. This number shall be divided by him equally among all the holders of certificates of preferred shares outstanding at such May first in proportion to the number of shares respectively represented by all such certificates in the name of each such holder, but if such division would result in any fractions of shares being allotted to any such holder, such fractions of shares shall be disregarded and not called for redemption, and the moneys which would have been available for that purpose shall be left in the sinking fund and held for the redemption of shares by the sinking fund in the ensuing year.

The notice for and manner of redemption of

Petitioner's Exhibit No. 3 (Continued)

preferred shares of the corporation shall be as follows:

Such notice must be in writing addressed to and, unless personally delivered, sent by United States mail to the respective holders of record of preferred shares to be redeemed at the respective addresses which they may have filed for such purpose with the Secretary of the corporation. If a shareholder file no address the notice to such shareholder shall be mailed to him addressed Los Angeles, California. The notice must be mailed (or personally delivered) at least thirty days prior to the date therein designated for such redemption. The notice of redemption shall state that on the redemption date designated, on surrender of the certificates representing the preferred shares called for redemption, duly endorsed in blank for transfer at such office in the United States as the corporation may designate, the holder and owner thereof will receive the redemption price described in this certificate. In case the preferred shares thus called for redemption are not thus duly presented for redemption, they shall, as stated in the certificate of incorporation, cease to share in further or later dividends.

The directors of the corporation may limit the transferability of common shares in the manner hereinafter described, but each certificate evidencing the ownership of such shares shall bear upon its face reference to this article of the by-laws or

Petitioner's Exhibit No. 3 (Continued)

a copy of the following provisions of this article.

In case a holder of a certificate representing common shares of the Corporation shall at any time desire to sell or give away any share or shares represented by such certificate to any person other than a person at the time actively associated with such shareholder in the business of producing photo-plays, he shall give notice in writing to the president at the principal business office of the Corporation describing the share or shares he desires to dispose of, the name of the party to whom such transfers are intended, the consideration (which must be stated in cash) to be received by such shareholder from such transferee, and shall at the same time deposit with the president at such office such certificate for shares duly endorsed in blank and stamped for transfer. The desired transfer of common shares shall not be made upon the books of the Corporation unless

(a) such transfer be by operation of law, or

(b) the transferee shall be a person associated in business with such shareholder as aforesaid, or

(c) twenty days have elapsed since the filing of such written notice and deposit of such share certificate, and no other shareholder of the Corporation shall have, in the manner hereinafter stated, given notice to the president that such other shareholder desires to acquire

Petitioner's Exhibit No. 3 (Continued)

such shares as to which notice of desire to transfer has been given.

Whenever any such notice of desire to transfer shall be filed with the President, he shall within two days after the receipt thereof cause a copy thereof to be sent by mail addressed to each person who is then a shareholder upon the books of the Corporation at his address as it appears upon such books. If thereafter and before the twenty days above mentioned shall have expired any such other shareholder desires to acquire such shares **for the same cash consideration** as shall be named in such notice of desire to transfer, he shall file a notice to that effect with the president at such office within such twenty day period accompanied by certified check for such cash consideration payable to or to the order of the president. If the president shall receive only one such notice from such other shareholder, he shall forthwith transfer the share certificates so desired into the name of such other shareholder and contemporaneously therewith pay to the shareholder giving notice of desire to transfer the amount of such consideration. If two or more shareholders shall both desire to acquire such shares, the president shall equally apportion such shares among such shareholders but if any such division would result in any fraction of shares being allotted to any such holder, the president shall determine by lot in such manner as he may deem reasonable and with

Petitioner's Exhibit No. 3 (Continued)

such formalities as he may deem wise which of such shareholders shall obtain such odd shares and shall return to the shareholders the difference between the amount deposited by them and the consideration for such shares as they are entitled to by the foregoing method of allotment.

ARTICLE VIII.

Amendments.

These by-laws may be altered, amended or repealed at any regular meeting of the shareholders or at any special meeting thereof duly called for that purpose, by a three-fourths vote of the shares represented and entitled to vote thereat; provided, that in the call for such special meeting, notice of such purpose shall be given. Subject to the law of the State of Delaware, the Certificate of Incorporation and these by-laws, the Board of Directors may, by unanimous vote of all present at any meeting at which a quorum is present, amend these by-laws or enact such other by-laws as in their judgment may be advisable for the regulation of the conduct of the affairs of the corporation, provided that no amendment shall be made in respect to Article VII hereof, except at a shareholders meeting.

ARTICLE IX.

Waiver of Notice.

Whenever, under the provisions of these by-laws or of any law, the shareholders or directors, or

Petitioner's Exhibit No. 3 (Continued)

any of the officers are authorized to hold any meeting or take any action after notice, or after the lapse of any prescribed period of time, such meeting or action may be held or taken without notice, or without such lapse of time on written waiver of such notice signed by every person entitled to notice.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: Next are photostatic copies of stock certificates representing shares of common stock of United Artists Corporation evidenced by certificates Nos. 19 to 27, inclusive. Each of these certificates is issued in the name of Charles Chaplin and each is dated June 9, 1919. [62]

The Court: How many altogether are there?

Mr. Green: Nine, your Honor.

The Court: The nine may be fastened together by the Clerk and may constitute one exhibit. Any objection?

Mr. Horner: No objection.

The Court: It may be received.

Mr. Horner: Exhibit 4.

(The said documents, so offered and received in evidence, were marked Petitioner's Exhibit 4, and made a part of this record.)

PETITIONER'S EXHIBIT No. 4

Consists of nine Common Stock Certificates, numbered from 19 to 27, inclusive, one of which is set out as follows:

Incorporated under the Laws of the State of
Delaware

No. 19

111 Shares

UNITED ARTISTS CORPORATION

Total Authorized Shares

8% cumulative preferred shares 5000 shares of the
par value of \$100.00 each. Common shares
9000 shares of no par value.
(Common)

This is to certify that Charles Chaplin is the owner of One Hundred and Eleven common shares of no par value of United Artists Corporation on the books of the Corporation transferable in person or by duly authorized attorney only upon surrender of this certificate duly endorsed and subject to the restrictions and limitations of transferability herein stated. For a statement of the rights, privileges and preferences and voting powers and the restrictions and qualifications of the preferred and common shares of the Corporation and of the provision for redemption of the preferred shares and the sinking fund therefor reference is made to the Certificate of Incorporation and the By-Laws of the Corporation.

The Board of Directors of the United Artists Corporation on April 24, 1919, drafted a resolution as follows:

“Resolved, That in accordance with the provisions of the Certificate of Incorporation of the Corporation and particularly the Fourth Article thereof and the portion of such Article dealing with transferability of common shares and in conformity with the By-Laws of the Corporation and particularly the Seventh Article of such By-Laws this Board prescribes the following limitation of transferability as to all common shares of the Corporation authorized, to wit, 9,000 shares; the right of holders of certificates representing such shares or any of them shall be limited in the manner provided in Article Seven of the By-Laws in case any holder of any such certificate representing any of such shares shall at any time desire to sell or give away any share or shares represented by such certificate to any person other than a person at the time actively associated with such share holder in the business of producing photo-plays. This limitation of transferability shall apply not only to each certificate for any of such 9,000 shares originally authorized when issued but to all other certificates for shares thereafter at any time issued against the transfer of such shares.”

Reference is made to such provisions of the Certificate of Incorporation and the By-Laws for a full statement of the limitation of transferability.

In Witness Whereof the Corporation has caused its corporate seal to be hereto affixed and this certi-

ificate to be signed by its duly authorized officers
this 9th day of June, 1919.

OSCAR A. PRICE,

President

G. B. CLIFTON,

Secretary

F. A. BEACH,

Asst. Secretary

Cancelled Oct. 31, 1928.

[Printer's Note—The printed form on the reverse
side of each stock certificate is not filled out, there-
fore is omitted.]

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: As Petitioner's Exhibit 5 I would
like to offer in evidence a memorandum of agree-
ment dated February 5, 1919, between Charles
Chaplin and United Artists Corporation.

Mr. Horner: No objection.

The Court: It will be received as Petitioner's
Exhibit No. 5.

(The said document, so offered and received
in evidence, was marked Petitioner's Exhibit 5,
and made a part of this record.)

PETITIONER'S EXHIBIT No. 5

Memorandum of Agreement, made in duplicate, (each copy to be considered for all purposes as an original), and entered into this fifth day of February, A. D. 1919, by and between Charles Chaplin, now residing in the City of Los Angeles, County of Los Angeles, State of California, hereinafter designated as "artist", party of the first part, and United Artists Corporation, a corporation organized pursuant to the laws of the State of New York and having its principal place of business in the City of New York, hereinafter designated as "corporation", party of the second part,

Witnesseth:

Whereas, Charles Chaplin is well and favorably known to the theatre-going public because of his extraordinary ability as an actor and photoplay artist and the name of Charles Chaplin has been extensively advertised throughout the United States of America and other parts of the world where motion picture attractions in which said pictures have appeared or have been produced under the supervision or direction of said artist have been exhibited, and the trade name and good will of said artist are of great value; and

Whereas, said corporation is desirous of inducing said artist to produce a series of so-termed Special Feature Photoplays for and during the period of this agreement, and of granting to said corporation the exclusive right, license and privilege of exploiting, marketing and turning to account and to exhibit, distribute or cause to be ex-

Petitioner's Exhibit No. 5—(Continued)

hibited and distributed said photoplays for the period of time and pursuant to the terms, conditions and provisions herein set forth; and

Whereas, said artist is desirous of making a series of Special Feature Photoplays during the period of time herein provided and of granting unto the corporation the exclusive right, license and privilege to exploit, market, turn to account, exhibit, distribute and cause to be exhibited and distributed the aforesaid series of photoplays, to be known as "Charles Chaplin Series of Photoplays", in the United States of America, Alaska, Newfoundland, and the Dominion of Canada, for the period and in the manner, and upon the terms and pursuant to the conditions and provisions hereinafter particularly set forth:

Now, Therefore, in consideration of the premises, and the mutual promises and covenants herein contained, and for the further consideration of the sum of One (\$1.00) Dollar each to the other in hand paid, the receipt whereof is hereby acknowledged, and of other artists mentioned in an agreement of even date herewith, executing and delivering that contract with said artist,

It Is Agreed by and between the parties hereto as follows:

First:

Production of Pictures

(a) Said artist agrees to provide at his own expense (including all taxes imposed upon or affecting

Petitioner's Exhibit No. 5—(Continued)

the negatives and positive prints of each of such photoplays), the corporation with a series of at least three (3) special feature motion picture photoplays in which said artist personally agrees to portray the leading character or role, such photoplays to be known as "Charles Chaplin Series of Photoplays", per year beginning upon the termination of the present contract between the artist and the First National Exhibitors Circuit, Inc., but in no event later than the first day of September, 1920, (the date of the delivery of said first photoplay to be determined by said artist, who shall give a written notice of such date to said corporation of at least four weeks prior to such date), for and during the period of the next ensuing three (3) years, totaling at least nine (9) such feature photoplays within such period, to consist of two (2) negatives of each photoplay, provided the making of two (2) negatives be permitted by the governmental authorities, (otherwise, one negative so long as such governmental restriction exists) and a sufficient number of complete positive copies to satisfy the demand for the use of said photoplay by the exhibitors, not to exceed One Hundred (100) Copies, cut and conformed to the sample print before said delivery and ready for projection purposes, as each photoplay is to be exhibited in the United States of America, such photoplays to be of the same high class as to photography, acting and direction as the photoplays said artist has appeared in during the past two (2) years, and to unfold an entertaining story

Petitioner's Exhibit No. 5—(Continued)

and to consist of between sixteen hundred (1600) and three thousand (3,000) lineal feet, the leading role in each of such photoplays to be portrayed by said artist; and one negative and the positive copies are to be delivered by said artist in the following manner: By notifying in writing, by registered mail or telegram, said corporation at its New York office at least two (2) weeks in advance of the date when said artist is prepared to deliver the aforesaid copies of each photoplay. Whereupon said corporation shall provide said artist with written directions where to send, at the expense of said corporation, the aforesaid copies of the aforesaid photoplays, and said artist shall agree to promptly comply with said directions.

(b) Said artist agrees to deliver while said artist is making each of such photoplays, or at the time of delivery of the negative or positive copies of each of such photoplays, such still plates made by such artist for such photoplay as the term is understood in the motion picture business, and in the judgment of said artist are desirable for advertising purposes of such photoplays, and such still plates may be used by said corporation in reproducing photographs for publicity and advertising purposes, and are to be returned to said artist in the same manner and subject to the same conditions as cover and affect the negatives and positive copies of such photoplays, as in this contract provided.

The aforesaid delivery of each of such aforesaid

Petitioner's Exhibit No. 5—(Continued)

photoplays and still plates is conditioned upon the payments and provisions herein set forth.

(c) The title of the negative and positive copies and still plates delivered to or procured by the corporation pursuant to this contract, for the purposes of this contract, shall remain in said artist, subject to the rights of the corporation as set forth in this agreement, and each negative and positive copy of each photoplay and the still plates, or so many as are then in existence, shall be returned to said artist by the corporation five (5) years from the date of release for exhibition purposes of the positive copies of each of such photoplays in the United States of America, at the last address provided said corporation by said artist, or such other place as the artist may direct in writing to the corporation at least thirty (30) days prior to the expiration of said five (5) year period.

(d) All other rights in and to the literary composition of each of said photoplays, and in and to the said photoplays themselves, except such rights as are specifically granted to said corporation by said artist pursuant to this agreement are reserved and withheld by said artist.

Second:

License to Make Motion Picture Copies

(a) Said artist does hereby grant, and by these presents has granted unto the corporation, the right to make, or cause to be made, such additional posi-

Petitioner's Exhibit No. 5—(Continued)

tive copies of each of such photoplays as in the judgment of said corporation may be necessary, to properly market and turn to account each of the aforesaid photoplays in all the territory hereinbefore described during said respective five (5) year periods, in no event to exceed fifty (50) such copies of such photoplays, except with the written consent of said artist first had and obtained; subject, however, to the artist's prior right to make or cause to be made such additional positive copies of each photoplay. The corporation shall inform said artist of the number of such additional positive copies of each photoplay so made and in use. The cost of such additional copies is to be paid from the earnings derived from the use of such positive copies prior to the earnings derived from the use of such positive copies being divided between the parties hereto; as hereinafter provided. And does further grant and by these presents has granted to said corporation the exclusive right and privilege to market and turn to account, exhibit, distribute or cause to be distributed or exhibited, said photoplays including all positive copies in all the territory hereinbefore described for and during said respective five (5) year periods.

(b) All replacements of the positive copies, or parts of the same shall be paid for from the earnings derived from such positive copies, or parts of same which have been so replaced by the corporation prior to the receipts derived from such *positive being* distributed hereto as hereinafter provided.

Petitioner's Exhibit No. 5—(Continued)

Third:

Advertising

(a) The name of Charles Chaplin shall receive "chief prominence", (and by "chief prominence" is meant that his name shall be in larger letters than, and at least twice the size of, any other part of the subject matter in which his name appears), in all advertising and literature used in connection with the exploitation of said photoplays by said corporation, and that the name of no other person shall appear in connection with the advertising and exploiting of each of said photoplays except as directed by said artist, except the name of the corporation and the name of the theatre in which the photoplays will be exhibited. All such advertising and literature shall be submitted to the artist or his duly constituted agent, at, and who shall have, a place at or in the Borough of Manhattan, City of New York, for his written approval, such approval not to be unreasonably withheld or delayed. In the event of such approval, or refusal to approve, not being given within three days of the date of delivery of such advertising or literature at such office, then the corporation may use the advertising and literary material so submitted or other advertising and literary matter substantially similar.

(b) The corporation shall supply exhibitors with first class lithographs in one or more colors with each photoplay at a reasonable price, in such quan-

Petitioner's Exhibit No. 5—(Continued)

tities as may be required by the exhibitor, the general character of the aforesaid lithographs to be submitted to the artist or his duly constituted agent, at, and who shall have, a place at or in the Borough of Manhattan, City of New York, for his written approval, such approval not to be unreasonably withheld or delayed. In the event of such approval, or refusal to approve, not being given within three (3) days of date of delivery at such office, then the corporation may use the lithographs so submitted or others substantially similar. Such lithographs shall be supplied to the exhibitor by the corporation at cost, plus a reasonable percentage of profit. The artist reserves the right to designate the person or corporation who is to manufacture such lithographs, subject, however, to his exercising his said right by notifying the corporation, at the time of or prior to the delivery of the negative and positive copies of the photoplay for which the lithographs are to be made.

(c) The press matter provided and circulated by the corporation relative to such photoplays, shall be submitted to the artist or his duly appointed agent at, and who shall have, a place of business in the Borough of Manhattan, in the City of New York, for his written approval, such approval not to be unreasonably withheld or delayed. In the event of such approval or refusal to approve, not being given within three (3) days from the date of delivery of the same at such office, then the corpora-

Petitioner's Exhibit No. 5—(Continued)

tion may use the material so submitted or material substantially similar.

(d) It is distinctly understood and agreed that after the photoplay is delivered to the corporation, no changes, interpolations, modifications, additions, or eliminations of any kind shall be made in any photoplay or any part thereof (this includes title and subtitles), except such changes as the corporation may be forced to make by a duly constituted Board of Censors, and each photoplay shall always be exhibited in the same order, arrangement, sequence and manner as when delivered to the corporation by the artist. The corporation shall not permit the exhibition of any photoplay delivered hereunder by any theatre owner or exhibitor except in the way and manner in this paragraph provided for, and all releasing contracts of the corporation shall be so drawn as to protect the artist in this particular, and in such contracts it shall be provided that the photoplay shall only be exhibited in the order, arrangement, sequence and manner as was the negative of such photoplay when it was completed and delivered by the artist to the corporation. The corporation hereby guarantees that it will, at its own expense, enforce these said provisions of its releasing contracts with other exhibitors.

(e) It is agreed by the parties hereto, that the motion pictures and photoplays of the artist enjoy universal popularity in the so-termed "Motion Picture World", and to maintain the same it is essential that the aforesaid series of photoplays be ex-

Petitioner's Exhibit No. 5—(Continued)

hibited in the largest number of motion picture theatres obtainable, and to be marketed in a fair manner and free from unfair methods in business; hence—the corporation agrees that all leases or licenses to use positive copies of such of said photoplays shall be made separate and apart from the leases or sales of other motion pictures or photoplays, and used in no way to influence the license, lease or sale of other motion pictures or photoplays, and the right, license or privilege to exhibit such motion pictures or photoplays shall not be denied any person or persons, firm or corporation exhibiting motion pictures or photoplays who is willing to pay a proper rental consideration for such a license or privilege, except in such theatres which would be in direct competition with the theatres for which contracts have already been made to exhibit such photoplays, or such theatres which do not regularly exhibit so-termed first class feature photoplays or do not represent first class theatrical entertainment, and subject also to the right of the corporation to grant reasonable territorial and time privileges in connection with the exhibition of the photoplays in question in favor of the theatre or theatres selected by the corporation to exhibit the photoplays in the immediate locality in question, as against any other theatre or theatres in the same locality.

(f) Said corporation agrees to use its best efforts to market the aforesaid photoplays upon a basis of the sharing in the gross receipts derived from the

Petitioner's Exhibit No. 5—(Continued)
exhibition of each of such photoplays in the particular theatre in question in cities where the photoplays of such artist had been heretofore exhibited for periods of a week or more and for as long a period in such theatres as the patronage of said theatre will reasonably warrant, consistent with the proper financial returns to said corporation and to said distributor.

(g) The artist reserves the right to designate a representative or representatives at his own expense, in any or all of the various offices of said corporation for the purpose of approving of the various contracts pertaining to the exhibition of such photoplays. No contract disapproved by such agent shall be made by the corporation unless approved by the artist.

(h) No agreement of franchise or territorial right for the use of any such photoplay shall be made or entered into by said corporation without written consent of said artist or his agent first had and obtained.

(i) And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation, nine (9) photoplays. Should said artist be unable to deliver nine (9) such photoplays because of illness or incapacity during the said entire period of three

Petitioner's Exhibit No. 5—(Continued)

(3) years, said artist shall receive so many of the aforesaid one thousand (1,000) shares of the common stock of this corporation as the number of photoplays delivered by said artist to this corporation pursuant to this agreement bears to the number of nine. The balance of the shares of such common stock shall be delivered by such escrow agent to this corporation.

Fourth:

(a) All moneys derived from the license to use each of the aforesaid photoplays for exhibition purposes shall be divided and belong to the parties hereto as follows: In the United States, Eighty (80%) per cent to said artist and twenty (20%) per cent to said corporation; in the Dominion of Canada, Newfoundland and Alaska, seventy (70%) per cent to said artist and thirty (30%) per cent to said corporation. The aforesaid consideration shall include all receipts of every kind and character derived from the use of said photoplays by said corporation or by the artist through the corporation, except from the sale of lithographs. The aforesaid consideration belonging to said artist shall be paid or be caused to be paid by the corporation within three (3) weeks from the end of each week for which the consideration has been derived from the use of such photoplays, except as to the consideration derived from the use of such photoplays outside of the United States of America, which shall be paid monthly; all payments shall

Petitioner's Exhibit No. 5—(Continued)

be accompanied with true and accurate statements showing the details of each rental including the name of the theatre, the dates when exhibited, and the rental or consideration paid for the use of the same.

(b) The duties and governmental taxes that apply to the importation or circulation of each of such photoplays shall be deducted from the gross receipts of such photoplays prior to receipts from such photoplays being divided between the parties hereto, but said corporation shall use its best efforts to procure the payment of such taxes by the persons or corporations exhibiting the same, if the same be lawful so to do.

Fifth:

Illness Affecting the Number of Photoplays

(a) Should the artist, because of illness or injury to him or for any cause beyond his control be unable to or fail to complete and deliver any of the minimum number of said series of photoplays to said corporation, providing said corporation will have complied with all of the material promises and obligations in this agreement on its part to be kept and performed, the number of such photoplays that said artist agrees to deliver to said corporation pursuant to this agreement shall be reduced in the proportion that the number of weeks of such illness bears to the total period of three (3) years.

(b) Should said artist be permanently disabled

Petitioner's Exhibit No. 5—(Continued)

or disfigured, so as to prevent his producing the character of photoplays covered by this agreement, this contract shall thereupon terminate and end except as to photoplays already completed. Said artist shall be thereupon relieved from further compliance with this agreement.

(c) Said artist agrees that in the event of the corporation violating any of the promises, covenants, and obligations of the corporation to be kept and performed pursuant to this agreement, that the corporation will have thirty (30) days in which to rectify such violation and comply with this contract after receiving notice to that effect by registered letter sent by said artist or his representative to the principal office of the corporation located in New York City, and to Douglas Fairbanks, David W. Griffith and Mary Pickford, or so many of them as are then producing motion pictures which are being distributed by the corporation, addressed to their respective business offices in either the City of New York or the City of Los Angeles, California; and until after the expiration of said thirty (30) days, the corporation shall not be deemed to be in fault.

Sixth:

(a) The corporation does hereby purchase and acquire, and by these presents has purchased and acquired from said artist, the exclusive right, license and privilege to market, turn to account, to exhibit, distribute or cause to be exhibited or dis-

Petitioner's Exhibit No. 5—(Continued)

tributed for exhibition purposes, the aforesaid series of at least three (3) photoplays per year, for and during the aforesaid period of five (5) full years, to be produced by said artist, and in each of which said artist agrees to portray the leading character as more fully described hereinbefore, pursuant to all the terms, conditions and provisions on the part of the corporation to be kept and performed as in this contract set forth.

(b) The corporation agrees to provide, where reasonably feasible, through ownership or contract relation and for the term hereof throughout such portions of the world, which are included in this agreement, where motion pictures of said artist are now being exhibited, exchanges or other method of distribution of sufficient number to reasonably satisfy the demand of such photoplays, in all of the respective division of said territory, and to offer said photoplays for exhibition purposes for so much of the aforesaid periods of this contract, as applies to said territory, as there may be a demand for the use and exhibition of such photoplays in said territory.

(c) The corporation agrees that the release date for exhibition purposes in the United States of America and the Dominion of Canada, shall be the respective dates designated by said artist, which dates shall be at least forty (40) days from, and within one hundred and twenty (120) days of, the

Petitioner's Exhibit No. 5—(Continued)

date of delivery of the negatives and positive copies of each of the aforesaid photoplays by the artist to the corporation, as herein provided. Such photoplays shall be offered for exhibition purposes in the United States of America, and the Dominion of Canada, from that date during the entire period of the license of such photoplays or so long as there is a reasonable demand for the same, and in other territory covered by this agreement, as the same can be reasonably marketed, and as long as the demand for the use of said photoplays in such territory warrants.

(d) The parties hereto agree that any waiver by said artist or the corporation of any breach of any kind or character whatsoever by the other, whether such waiver be direct or implied, shall not be construed as a continuing waiver of, or consent to, any subsequent breach of this contract on the part of the other, and particularly as regards the making and delivery of the statements and of the keeping of the accounts, and of the delivery of the photoplays herein provided.

(e) The corporation agrees to keep true and accurate books of accounts in which shall be entered all details of every kind and character pertaining to the business of this enterprise, and all contracts pertaining to the marketing and exhibiting of said photoplays from the various theatres in which they are exhibited, which shall be open to the inspection of said artist or his representative or accountant at all reasonable times.

Petitioner's Exhibit No. 5—(Continued)

Seventh:

(a) Said corporation and said artist agree that this contract is personal in respect to each of the parties hereto, and that neither can assign the same nor permit the same to be transferred by involuntary act, by operation of law or otherwise, without a written consent of the other first had and obtained; nothing herein contained, however, shall prevent the artist from assigning this contract after said artist shall have completed and delivered to the corporation the photoplays herein provided, subject, however, to the artist remaining liable as principal upon said contract.

(b) The corporation, however, consents that this agreement may be assigned by the artist to a corporation or copartnership, provided such assignment shall be evidenced by an instrument in writing duly executed under seal and acknowledged by the assignee, and be delivered to the corporation, wherein and whereby such assignee shall accept and assume all the terms and covenants of this agreement, to be kept and performed by the said artist and become personally bound to comply therewith. The consent to such proposed assignment shall not release said artist from any of the terms, covenants, and conditions in this agreement contained; and in the event of such assignment, said artist agrees to personally direct the production of each photoplay and to personally portray and represent the star and leading role in each photoplay, and to continue

Petitioner's Exhibit No. 5—(Continued)

liable as principal jointly and severally with such corporation or copartnership as to all the terms and covenants hereof and for any default in the faithful performance of this agreement by such assignee and himself or either of them.

Eighth:

(a) The corporation agrees that the artist may produce and deliver the aforesaid photoplays at such times as to him may seem desirable, provided the negative and positive copies of the first of aforesaid photoplays be delivered to said corporation on or before the first day of September, 1920, and the remainder not less than two (2) nor more than six (6) months from the date of the delivery of the last previous photoplay, and provided that at least three (3) of such photoplays shall be delivered during each year of the aforesaid period, except as otherwise herein provided.

(b) Said artist agrees that the services said artist shall render pursuant to which the corporation shall benefit, under the provisions of this agreement, are special, unique, and extraordinary and the same cannot be replaced, and because of such and for the consideration paid and to be paid said artist pursuant to this agreement, said artist agrees not to render any services either as producer of motion pictures where his name may be used in any manner pertaining to the marketing, exhibiting and turning to account such motion picture, or as an

Petitioner's Exhibit No. 5—(Continued)

actor in the production of said motion picture to or for any person, persons, firm or corporation, relative to the making of motion pictures or photoplays from the period beginning from the time he will have commenced to produce his first photoplay covered by this agreement, which shall be not later than the first day of September, 1920, and continuing for three (3) full years from that date, or until this contract is legally terminated. It is agreed that said artist may supervise and be or become interested in, other motion picture productions than those covered by this agreement, provided; and that an injunction shall issue to restrain manner in connection with such motion pictures, and provided such do not prevent said artist from making at least three (3) motion pictures per year to be marketed by said corporation as herein provided; and that an injunction shall issue to restrain the artist from any violation of this agreement on his part, such injunction being necessary to protect and preserve the rights of the corporation and to prevent irreparable damage. Nothing herein contained shall prevent the said artist from using his name in the exploiting and turning to account of the motion pictures produced prior to his beginning to produce motion pictures to be marketed and turned to account by said corporation pursuant to the provisions of this agreement.

(c) The corporation agrees that said artist may produce, if said artist so elect, not more than one

Petitioner's Exhibit No. 5—(Continued)

so-termed unusual or special motion picture per year of at least three thousand (3,000) lineal feet in length, and such motion picture shall not be included or covered by this agreement, provided the production of such motion picture does not prevent said artist from producing at least three (3) of such series of photoplays as is herein provided; and such unusual or special motion picture shall not be released for exhibition purposes until said artist shall have delivered the minimum number of his photoplays to said corporation for and during the year in question.

And, provided further, that in releasing or exhibiting each such unusual or special motion picture, the artist shall provide by his releasing or exhibiting contracts that the admission to be charged by any exhibitor shall be at least fifty (50%) per cent more than the usual and customary prices of admission in that particular motion picture theatre in which the photoplay is being exhibited. Such unusual or special motion picture may be exhibited in any legitimate theatre by the artist without increase in prices above the customary prices of such legitimate theatre.

Ninth:

(a) The corporation agrees to properly care for the negatives in fire-proof vaults, and still plates of the aforesaid series of photoplays, except at such times as it is necessary to have them removed for the purpose of making prints of the same, and

Petitioner's Exhibit No. 5—(Continued)

to return such negatives and all positive copies and still plates then in existence, upon the expiration of the respective period of the license of each of such photoplays, or the sooner termination of this contract, to said artist, the negatives to be in the same condition as when delivered, subject to reasonable wear and tear occasioned by usage. Should said corporation be unable to return any of the negatives or positive prints or still plates because of loss through their own destruction, or because of any act beyond the control of said corporation or its employees, it shall provide in lieu thereof reasonable satisfactory proof of such loss or destruction to said artist.

Tenth:

Infringements.

(a) Said artist agrees to indemnify and hold harmless the corporation on account of and against any claims, demands or suits which may be made or brought by third parties, questioning the right, license and privilege of said corporation, its exchanges, members and licensees to use such photoplays in the full exercise of the rights hereto granted or purported to be granted to the corporation by said artist, and said artist agree to join in and conduct the defense of any such claim or litigation.

(b) The corporation agrees to promptly begin and prosecute all actions necessary to enjoin and prosecute any unlawful use of said photoplays or

Petitioner's Exhibit No. 5—(Continued)

the infringement of the copyright thereof within the territory covered by this agreement.

Eleventh:

Said artist does hereby constitute and empower the corporation as attorney in fact to procure, and said corporation does agree to procure copyrights in said countries of North America where copyrights are procurable of each of said photoplays, in the name of said artist, at the expense of the corporation.

Twelfth:

Censorship Clause.

(a) Should any legally constituted Board of Censors in the United States of America or Canada, having power and authority to prevent the circulation or distribution of photoplays, condemn or prohibit the exhibition of any such photoplay, or require the excision of any substantial portion of any such photoplay, the artist agrees to replace or rearrange that portion of said photoplay so condemned, with reasonable promptness if same be practicable and desirable, the opinion of said artist to be final in said matter.

Thirteenth:

Said artist, in consideration of the corporation's entering into and executing this agreement, and as an inducing cause of Douglas Fairbanks, David W. Griffith, and Mary Pickford's executing and

Petitioner's Exhibit No. 5—(Continued)

delivering contracts substantially similar to this contract, between each of them respectively and this corporation, agrees with them and with this corporation that he will not directly or indirectly dispose of any right, title or interest of his in and to the license or privilege to exhibit or cause to be exhibited any of his aforesaid photoplays covered by this agreement in parts of the world other than included in this agreement, prior to December 1, 1919, it being the intention of the parties in this paragraph mentioned to withhold such license and privilege relative to their respective photoplays covered by this agreement, until the said corporation shall have had an opportunity to investigate and determine the best method for the parties hereto concerned to market, exploit, and turn to account the aforesaid photoplays in other parts of the world and to procure sufficient reliable information that will enable all of the parties mentioned in this paragraph to determine an equitable basis and the best method for the marketing and turning to account of their respective photoplays in other parts of the world.

Fourteenth:

The parties hereto agree that this agreement shall be construed as in no sense a copartnership between the parties hereto, and that either shall have no authority to bind the other as his representative in any way, shape or form except as specifically provided in this agreement for the pur-

Petitioner's Exhibit No. 5—(Continued)

pose of marketing, exploiting and turning to account the aforesaid photoplays in the particular territory covered by this agreement.

Fifteenth:

This contract is binding upon the parties hereto, their respective heirs, legal representatives and assigns, except as hereinbefore provided.

This contract cannot be amended except with the written consent of said Griffith, Fairbanks and Miss Pickford.

This contract shall be construed and enforced pursuant to the laws of the State of New York.

In Witness Whereof, the parties to this agreement have executed the same the day and year first above written.

CHARLES CHAPLIN,
UNITED ARTISTS
CORPORATION,
By OSCAR A. PRICE,
President.

Attest:

[Seal]

B. CLIFTON,
Secretary.

(25c Stamps)

State of California,
County of Los Angeles—ss.

On this 5th day of February, 1919, before me, Arthur Wright, a Notary Public in and for said County, residing therein, duly commissioned and

Petitioner's Exhibit No. 5—(Continued)
sworn, personally appeared Charles Chaplin, known to me to be the person whose name is subscribed to the within agreement, and acknowledged to me that he executed the same.

Witness my hand and official seal.

[Seal] ARTHUR WRIGHT

Notary Public in and for said County of Los Angeles, State of California.

State of New York,
County of New York—ss.

On the 13th day of June in the year one thousand nine hundred and nineteen, before me personally came Oscar A. Price, to me known, who being by me duly sworn, did depose and say that he resides in the Borough of Manhattan, City and State of New York; that he is the President of the United Artists Corporation, the corporation described in and which executed the above instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal, that it was so affixed by order of the Board of Direc-

Petitioner's Exhibit No. 5—(Continued)
tors of said corporation, and that he signed his name
thereto by like order.

[Seal]

H. H. STREIMER

Commissioner of Deeds for the
City of New York, residing
in Kings County

Certificate filed in N. Y. County.

County Clerk's No. 512.

Register, N. Y. County No. 20192.

Commission expires Sept. 24, 1920.

[Endorsed]: U. S. B. T. A. Filed Feb. 26, 1941.

Mr. Green: I would now like to offer in evidence
conformed copy of an agreement dated July 5, 1919,
between Charles Chaplin, Douglas Fairbanks, David
W. Griffith, Gladys Mary Moore, professionally
known as Mary Pickford, and the United Artists
Corporation. [63]

Mr. Horner: No objection.

The Court: It will be received as Petitioner's
Exhibit No. 6.

(The said document, so offered and received
in evidence, was marked Petitioner's Exhibit
6, and made a part of this record.)

PETITIONER'S EXHIBIT No. 6

Agreement made this 5th day of July, 1919, between Charles Chaplin, party of the first part, and Douglas Fairbanks, party of the second part, and David W. Griffith, party of the third part, and Gladys Mary Moore (professionally known as Mary Pickford), party of the fourth part, and United Artists Corporation, party of the fifth part.

In consideration of the sum of One Dollar (\$1.00) each to all the other parties in hand paid, receipt of which is hereby individually acknowledged by all the parties hereto, each and all of the parties hereto agree with each other and all the others as follows:

First: Subdivision (i) of Paragraph 3 of each of four (4) certain contracts dated February 5, 1919, between Charles Chaplin and United Artists Corporation, Douglas Fairbanks and United Artists Corporation, David W. Griffith and United Artists Corporation, and Gladys Mary Moore (professionally known as Mary Pickford) and United Artists Corporation shall be and hereby is amended to read as follows:

And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation to be issued in the name of the said Artist in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each and one of which shall be for one hundred and twelve (112) shares, said certificates to be delivered in escrow to a person or corporation to be agreed

upon by the parties hereto. Upon delivery by the said Artist to the said corporation of each one (1) of the first eight (8) photoplays called for by this contract, such escrow agent shall deliver to the said Artist one (1) of said certificates for one hundred and eleven (111) shares, and upon delivery by the said Artist to the said corporation of the ninth (9th) photoplay called for hereunder, such escrow agent shall deliver to the said Artist said certificate for one hundred and twelve (112) shares. Upon the expiration of the three-year period herein provided for, so many of said certificates as are then still held by such escrow agent in accordance with the provisions of this paragraph shall be delivered by such escrow agent to the said corporation.

Second: In all other respects said contract shall remain in full force and effect.

In Witness Whereof, the parties hereto have here-

unto set their hands and seals the day and year first above written.

In the presence of:

THOMAS HARRINGTON

JOHN FAIRBANKS

I. A. WIENER

FINLEY E. BENSON

G. B. CLIFTON

Secretary

CHARLES CHAPLIN (L.S.)

DOUGLAS FAIRBANKS (L.S.)

D. W. GRIFFITH (L.S.)

GLADYS MARY MOORE (L.S.)

known as Mary Pickford

UNITED ARTISTS COR-

PORATION (L.S.)

By OSCAR A. PRICE

President

(Seal of U. A. Corp.)

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: I would like to offer in evidence a conformed copy of an agreement dated August 5, 1919, between United Artists Corporation, Charles Chaplin and Dennis F. O'Brien, as Petitioner's Exhibit 7.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 7, and made a part of this record.)

PETITIONER'S EXHIBIT No. 7

Agreement made this 5th day of August, 1919, between United Artists Corporation (hereinafter called the "Corporation"), party of the first part, Charles Chaplin (hereinafter called the "Artist"), party of the second part, and Dennis F. O'Brien (hereinafter called the "Depositary"), party of the third part.

Whereas the Artist on the 5th day of February, 1919, executed a certain contract to be entered into with the Corporation, which said contract has been subsequently ratified and adopted by the Corporation, whereby the Artist agreed to provide the Corporation with a series of at least three photo-plays per year, beginning upon termination of the present contract between the Artist and the First National Exhibitors Circuit, Inc., but in no event later than the first day of September, 1920, for and during the period of the next ensuing three years, totaling at least nine such photo-plays within such period, in part consideration of the issuance by the Corporation to the Artist of one thousand shares of its common stock, having no par value, and

Whereas said contract, as amended by the parties thereto, provides that said one thousand (1000) shares of stock shall be issued in the name of the Artist in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each and one (1) of which shall be for one hundred and twelve (112) shares, said certificates to be delivered in escrow to a person or cor-

poration to be agreed upon by the Artist and the Corporation and to be delivered one by one by such escrow agent to the Artist as each of said nine (9) photo-plays is delivered by the Artist to the Corporation, and

Whereas said contract, as amended, further provides that upon the expiration of said three-year period so many of said certificates as are then still held by such escrow agent in accordance with the provisions thereof shall be delivered by such escrow agent to the Corporation, and

Whereas, pursuant to the terms of said contract, the Corporation has issued in the name of the Artist nine (9) certificates of stock, of which eight (8) are for one hundred and eleven (111) shares and of which one (1) is for one hundred and twelve (112) shares, which certificates are still in the possession of the Corporation, and

Whereas, pursuant to the terms of said contract, Dennis F. O'Brien, Esq., 1482 Broadway, New York City, has been designated by the Corporation and the Artist to act as escrow agent hereunder.

Now, Therefore, in consideration of the premises and of the agreements herein set forth, and of the sum of one dollar, each to all the other parties in hand paid, receipt of which is hereby individually acknowledged by all the parties hereto, each and all of the parties hereto agree with each other and all the others as follows:

First: The Corporation shall forthwith deliver to, and deposit with, the Depositary the nine (9) stock certificates, representing in the aggregate one

thousand (1,000) shares of the common stock of the Corporation, which have been issued in the name of the Artist as aforesaid.

Second: Upon receipt of said stock certificates, the Depositary shall issue in respect thereof in the name of the Artist a certificate of deposit in substantially the form hereto annexed and marked Exhibit "A".

Third: Upon delivery by the Artist to the Corporation of each one (1) of the first eight (8) photo-plays called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to one (1) of said certificates for one hundred and eleven (111) shares, whereupon the Depositary shall deliver one (1) of the same to the Artist upon surrender by the latter of the certificate of deposit herein provided for and shall issue to the Artist a new certificate of deposit, substantially in the form of that annexed hereto, in respect of the number of shares remaining in escrow. Upon delivery by the Artist to the Corporation of the ninth (9th) photo-play called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to said certificate for one hundred and twelve (112) shares, whereupon the Depositary deliver the same to the Artist upon surrender by the latter of the certificate of deposit which he then holds. At the expiration of said period of three years, the Depositary shall deliver to the Corporation so many of the certificates deposited hereunder as then remain in escrow and are not the property

of the Artist, and the Artist shall return to the Depositary the certificate of deposit which he then holds.

Fourth: Any and all dividends which may be declared upon the shares of stock represented by the certificates deposited hereunder while the same, or any part thereof, are held in escrow by the Depositary shall be deposited by the Corporation in the Central Union Trust Company, No. 80 Broadway, New York City, in an account to be known as "United Artists Corporation, Trust Account No. 1". Upon delivery to the Artist by the Depositary, in the manner hereinbefore provided for, of each of the certificates deposited hereunder, the Corporation shall pay to the Artist one-ninth ($1/9$ th) of all dividends which at the time of such delivery shall have been deposited in said account, together with accrued interest thereon. At the expiration of said period of three years, so much of such dividends and interest thereon as remain in said account and are not due the Artist shall become the property of the Corporation.

Fifth: The Depositary shall not have the right to vote the shares of stock deposited hereunder.

Sixth: This agreement shall not become binding or effective until signed by the Depositary at the end hereof, and such signature by the Depositary shall constitute an agreement by the Depositary with the Corporation and the Artist to act as Depositary in accordance with the provisions hereof and of the contract between the Corporation and the Artist hereinbefore referred to. The Depositary shall not

be liable hereunder to any of the parties hereto for any act of omission or commission not involving fraud or breach of good faith in carrying out any of the obligation herein contained. The Corporation shall reimburse the Depositary for such expenses as he may incur in connection with the safe keeping of the certificates deposited hereunder.

Seventh: This agreement shall be binding upon the heirs, legal representatives, successors and assigns of the parties hereto.

In Witness Whereof, the parties hereto have hereunto set their hands and seals the day and year first above written.

In the presence of:

NATHAN BENTON

[Illegible]

UNITED ARTISTS COR-

PORATION (L.S.)

By OSCAR A. PRICE

Prest

CHARLES CHAPLIN (L.S.)

DENNIS F. O'BRIEN (L.S.)

Mr. Green: I would like to offer a conformed copy of an agreement dated November 22, 1924, between Mary Pickford Fairbanks, Charles Chaplin, Douglas Fairbanks, Joseph M. Schenck, and United Artists Corporation. This agreement also has attached to it a letter to Mr. Charles Chaplin, which

is signed by Mary Pickford Fairbanks, Douglas Fairbanks United Artists Corporation and Joseph M. Schenck. I would like to offer the two as one exhibit.

The Court: They are now fastened together?

Mr. Green: Yes. [64]

Mr. Horner: No objection.

The Court: They may be received as Petitioner's Exhibit No. 8.

(The said documents, so offered and received in evidence, were marked Petitioner's Exhibit 8, and made a part of this record.)

PETITIONER'S EXHIBIT No. 8

To Charles Chaplin

Dear Sir:

Supplementing the agreement executed this date, it is agreed that if, for any reason, it becomes necessary for you to deliver to United Artists Corporation, motion pictures in which you do not personally appear, that those motion pictures will be accepted in lieu of the ones provided in your original agreement, as modified by the agreement of even date herewith, relative to the common stock that you are to receive upon the delivery of your motion pictures to the United Artists Corporation, pursuant to the aforesaid agreements, and you shall be entitled, upon the delivery of such productions, to receive the one-fifth (1/5th) of the undelivered common stock, and each of such productions shall be

Petitioner's Exhibit No. 8 (Continued)
counted as being deliveries under the terms of the original contract, as modified by this agreement. Such productions shall be produced or supervised by you and shall be features.

MARY PICKFORD FAIR-
BANKS

DOUGLAS FAIRBANKS

[Corporate Seal] UNITED ARTISTS CORP.

per DENNIS F. O'BRIEN,

Vice-Pres.

JOSEPH M. SCHENCK

By EDWIN J. LOEB

His Atty in Fact.

Accepted

CHARLES CHAPLIN

Agreement executed at New York, N. Y., November 22nd, 1924, by and between Mary Pickford Fairbanks, of Los Angeles, California, hereinafter sometimes referred to as "Miss Pickford", Charles Chaplin, of Los Angeles, California, hereinafter sometimes referred to as "Chaplin", Douglas Fairbanks, of Los Angeles, California, hereinafter sometimes referred to as "Fairbanks", Joseph M. Schenck, of Los Angeles, California, hereinafter sometimes referred to as "Schenck", and United Artists Corporation, a Delaware corporation, having its principal place of business at 729 Seventh Avenue, in the city of New York, hereinafter sometimes referred to as the "corporation",

Petitioner's Exhibit No. 8 (Continued)

Witnesseth:

The parties herein contracting do so with reference to the following facts:

Miss Pickford, Chaplin and Fairbanks heretofore entered into divers agreements with each other and with David W. Griffith, of Mamaroneck, county of Westchester, state of New York, hereinafter sometimes referred to as "Griffith", resulting in the formation of the corporation and the execution of distribution agreements between each of said persons and the corporation and extensions of each of said distribution agreements other than the one between Chaplin and the corporation. Griffith has notified the corporation that he has assigned certain contractual rights held by him in such connection to D. W. Griffith's, Inc., and wherever in this agreement such construction is necessary, a reference to Griffith shall also be deemed to include a reference to said D. W. Griffith's, Inc. Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all of the preferred and common stock of the corporation, now issued and outstanding, other than certain qualifying shares issued to directors. Schenck has agreed to distribute through the corporation a series of six (6) motion picture feature photoplays starring Norma Talmadge, and to enter into an appropriate distribution agreement in connection therewith, on the conditions hereinafter specified. It is Therefore Mutually Agreed as Follows:

Petitioner's Exhibit No. 8 (Continued)

ARTICLE I.

Section 1. The term of the distribution agreement between Miss Pickford and the corporation is hereby extended for a period necessary to enable Miss Pickford to, and she hereby agrees to, deliver to the corporation for distribution, in addition to the nine (9) pictures originally contracted for, six (6) feature photoplays, starring her, at the rate of not less than two (2) per year, and in any event all six (6) photoplays shall be delivered on or before November 1, 1928, said photoplays to be delivered and distributed on the same terms and conditions as are set forth in the original distribution agreement, except:

(a) Miss Pickford shall receive no additional common stock beyond the amounts provided to be delivered to her during the original term of said contract.

(b) The provisions of Article IV hereof.

ARTICLE II.

Section 1. The term of the distribution agreement between Fairbanks and the corporation is hereby extended for a period necessary to enable Fairbanks to, and he hereby agrees to, deliver to the corporation for distribution, in addition to the nine (9) pictures originally contracted for, five (5) feature photoplays, starring him, at the rate of not less than one (1) per year, or three (3) in two years, and in any event all five (5) photoplays shall be delivered on or before November 1, 1928, said

Petitioner's Exhibit No. 8 (Continued)

photoplays to be delivered and distributed on the same terms and conditions as are set forth in the original distribution agreement, except:

(a) Fairbanks shall receive no additional common stock beyond the amounts provided to be delivered to him during the original term of said contract.

(b) The Provisions of Article IV hereof.

Section 2. Fairbanks agrees to close the roadshows of his motion picture photoplay "The Thief of Bagdad" and to deliver the same for distribution purposes to the United Artists Corporation not later than January 1st, 1925.

ARTICLE III

Section 1. Chaplin and the corporation agree to, and do hereby modify the Chaplin distribution agreement so that Chaplin shall be obligated to deliver to the corporation for distribution only five (5) additional motion picture photoplays, described in the original contract instead of the eight (8) undelivered pictures provided for in said contract. The balance of the common stock of the corporation, which is now held in escrow for the benefit of Chaplin, shall be delivered to him in the proportion of one-fifth ($1/5$) thereof upon delivery of each motion picture photoplay by Chaplin to the corporation, as in said contract provided. Chaplin agrees to deliver to the corporation not less than one (1) motion picture photoplay per year, commencing at the date hereof, and to deliver all

Petitioner's Exhibit No. 8 (Continued)

five (5) of said photoplays on or before January 1, 1929. Chaplin also agrees to the provisions of Article IV hereof.

Section 2. Notwithstanding the provisions of Article IV hereof, it is agreed that should the financial returns from the foreign marketing, exploitation and turning to account for exhibition purposes, of the motion picture photoplay of Chaplin, about to be delivered to the corporation, not be satisfactory in his sole and absolute judgment to Chaplin, he shall have the right, as to all subsequent motion picture photoplays produced by him, to market the same in all parts of the world, other than the United States of America, Dominion of Canada, Mexico, Cuba, and other parts of the North American hemisphere, through persons or corporations other than the United Artists Corporation, or its subsidiary corporations, providing he gives written notice to the corporation to that effect at least sixty (60) days prior to delivery of the second motion picture photoplay which he is to deliver to the corporation hereunder.

ARTICLE IV.

Section 1. The license to distribute the motion picture photoplays of the parties hereto, granted to the corporation and its subsidiary corporations, shall extend to all parts of the world and shall be subject to the foreign charges for distribution and the terms, conditions and provisions prevailing

Petitioner's Exhibit No. 8 (Continued)

in the existing distribution agreements between Miss Pickford and the corporation, Faribanks and the corporation, and Chaplin and the corporation for the motion picture photoplay "The Woman of Paris", to-wit: said rates or charges for distribution being as follows:

England, Australia and Canada,	30% of the gross
Continental Europe, South America, Japan, Cuba and Mexico	40% of the gross
Other territories, not specifically mentioned, not exceeding	40% of the gross

The above rates apply to those countries where the United Artists Corporation, or its subsidiary corporations, maintain exchanges and actually distribute motion pictures in those countries, and five percent (5%) of the gross amount collected from licensee shall apply in such countries where the corporation does not directly distribute, all such contracts to be subject to the written approval of the owner of the motion picture first had and obtained. Should the actual cost of distribution to the corporation of the said photoplays herein referred to in the 40% territories above referred to be actually less than 40%, then appropriate refunds shall be made to the individual producers in each instance so as to reduce the actual distribution cost to them to the actual distribution cost to the corporation, such refunds to be based on two (2) year periods beginning January 1, 1925.

The reference to the corporation, as used in this Article, shall include not only the United

Petitioner's Exhibit No. 8 (Continued)

Artists Corporation but also each and all of its subsidiary corporations now operating and doing business, or which may be created from time to time by the United Artists Corporation for the purpose of transacting business for it in various parts of the world, provided, however, that no charges for distribution shall be increased above the rates hereinbefore specified, by reason of the creation of any such corporations.

Section 2. All parties hereto agree that the charge for distribution in the United States of America, with reference to any photoplays heretofore or hereafter delivered by the parties hereto to the corporation, shall be twenty-five per cent (25%) on all contracts made by the corporation after January 1st, 1925, instead of the percentages heretofore prevailing; that should any owner of any photoplay decide to roadshow any photoplay subsequent to January 1st, 1925, he shall pay to the corporation a percentage of the net profits derived from such roadshowing of such photoplay, within thirty (30) days from the closing of the roadshows of such photoplay, the amount of such percentage to be determined by the chairman of the board of directors of the corporation and the owner of such photoplay, and in the event of their inability to agree, such amount shall be determined by a neutral third person to be selected by them. In the event of their failure to agree upon such selection, then such third person shall be selected

Petitioner's Exhibit No. 8 (Continued)

by the board of directors of the corporation, but in no event shall such percentage to be paid to the corporation exceed ten per cent (10%), unless the owner of such photoplay expressly consents thereto.

ARTICLE V.

Section 1. Schenck and the corporation agree to enter into an agreement providing for the distribution of six (6) motion picture feature photoplays, starring Norma Talmadge, said agreement to contain substantially the same terms as those set forth in the distribution agreement between Miss Pickford and the corporation, allowing for such appropriate changes as should be made, inasmuch as Schenck will function as the producer, manufacturing and delivering the photoplays, and Miss Talmadge as the star, whereas, in the case of Miss Pickford, she functions both as producer and star, and except, furthermore, that Schenck agrees that the provisions of Article IV shall apply to the distribution of said photoplays. Schenck agrees, however, that Miss Talmadge will execute and deliver to the corporation an agreement in writing whereby and whereunder she shall agree to perform all obligations required of her in order to enable Schenck to fulfill his obligations under said distribution agreement, and providing, further, that in the event of the death or incapacity of Schenck, and in the further event that Schenck has not otherwise provided for the completion of his obli-

Petitioner's Exhibit No. 8 (Continued)

gations under said contract, she will carry out, perform and observe the same to the end that the corporation will be assured of receiving delivery of all six (6) photoplays. Said photoplays shall be delivered by Schenck to the corporation at the rate of not less than two (2) per year, and in any event all six (6) photoplays shall be delivered on or before November 1, 1928. The term of said distribution agreement shall commence November 1st, 1925. Said distribution agreement shall provide for the delivery to Schenck of One Thousand (1000) shares of the common stock of the corporation, said stock to be held in escrow in like manner as was provided with reference to Miss Pickford's stock, one-sixth ($1/6$) thereof, or One hundred sixty-six and two-thirds ($166\frac{2}{3}$) shares to be delivered to Schenck on delivery of each photoplay. At all times, however, Schenck shall be entitled to the same rights in the escrowed stock as are held by other parties hereto under similar agreements.

Section 2. Schenck hereby subscribes for the same amount of preferred stock of the corporation as has been subscribed for by each of the other parties to this agreement, other than the corporation, namely, One thousand (1000) shares of the par value of One hundred dollars (\$100.00) each, and he agrees to pay the sum of Thirty thousand dollars (\$30,000.00) in cash for three hundred (300) shares thereof, forthwith upon the execution

Petitioner's Exhibit No. 8 (Continued)
of this agreement. All parties hereto, except the corporation, agree to pay for the balance of said preferred stock so subscribed for by them from time to time as called upon in writing by the board of directors, provided, however, that like demands shall be served on all subscribers.

ARTICLE VI.

Section 1. The parties hereto severally ratify and confirm the action of the board of directors in increasing the number of directors from five (5) to six (6), and in electing Schenck as a member of said board.

Section 2. As a material inducement and as part of the consideration to Schenck to enter into this agreement, the other parties hereto have agreed and do hereby agree:

(a) To cause appropriate amendments to be made to the bylaws of the corporation, creating the office of chairman of the board of directors, whose powers and duties shall be as follows, to-wit: he shall preside at all meetings of the board of directors; he shall exercise a general supervision over the affairs of the corporation and over all other officers and employees other than the directors; he shall have the sole and absolute power to execute contracts with outside producers for not exceeding a total of six (6) motion picture feature photoplays from all outside producers per year, for delivery to the corporation not later than No-

Petitioner's Exhibit No. 8 (Continued)

vember 1, 1928, on such terms and conditions as may be approved by him, provided, however, that he shall not obligate the corporation to finance the whole or any part of the production of such photoplays or to guarantee the financial returns upon such photoplays, or agree to distribute said photoplays, or any of them, for any less percentage of earnings to the corporation, or on any more favorable terms, than are provided for in the distribution agreements of the respective parties hereto, it being understood that the chairman of the board of directors shall be entitled to be financially interested in the production of any such photoplays, provided, however, that he shall in every instance accord to the other parties to this agreement, other than the corporation, the right to participate in such financing on the same basis as he himself may be interested. The foregoing shall not be construed so as to prevent the board of directors from authorizing the execution of agreements with other producers for other product in addition to the six (6) pictures per year herein provided for. In connection with the foregoing, it is understood by the parties hereto that Schenck, who is to be the chairman of the board of directors as is hereinafter provided, may organize a finance corporation for the purpose of assisting in the financing of various outside productions, as hereinabove in this subdivision provided for; that in the event he does organize such finance corporation,

Petitioner's Exhibit No. 8 (Continued)

the other parties hereto, other than the corporation, will be invited to become financially interested therein to such proportion as such person may elect, but in no event exceeding the amount that Schenck is interested in said corporation, and in the event that they or their respective nominees fail to become so interested, thereafter they shall not be entitled as a matter of right to participate in the financing of any individual production which may be financed in whole or in part by such finance corporation.

(initialed) U. A. Corp per D.F.O'B. C. C.
D. F. M. P. JMB By EJL

(Rider) Each party hereto, however, reserves the right to control and determine the sales and distribution policy to apply to, and to govern his own productions, and each party further reserves the right to require the corporation to book his own productions with such exhibitors and upon such terms and conditions as he may deem fit. This provision shall be deemed an amendment to the respective distribution contracts now in force between the Corporation and the respective parties hereto.

(Rider) Neither the words "United Artists" or any words similar thereto, nor the name of any party hereto not assenting, shall be used as the title or name, or part of the title or name of the finance corporation, or

Petitioner's Exhibit No. 8 (Continued)

in connection with such finance corporation for publicity, trade, or advertising purposes.

(b) To appoint Schenck to the office of chairman of the board of directors and to continue him in said office until at least November 1, 1928.

(c) Not to repeal, amend or revoke said amendments prior to the date last above mentioned.

Section 3. Schenck shall receive no compensation for any services rendered by him in such capacity prior to January 1st, 1927, at which time the board of directors shall determine, by a majority vote, as to what compensation he shall receive for services rendered by him prior to such date, and what compensation he shall receive thereafter, such compensation to be paid only out of the net profits of the corporation.

ARTICLE VII

Section 1. Griffith shall be at liberty to join in the execution of this agreement as a party hereto, in which event he shall be bound by all of the provisions hereof in like manner as though he had signed this agreement originally; and furthermore, the following article shall be deemed included in this present agreement.

“The term of the distribution agreement between Griffith and the Corporation is hereby extended for a period necessary to enable Griffith to, and he hereby agrees to, deliver to the corporation for distribution five (5) additional feature photoplays at the rate of not less than

Petitioner's Exhibit No. 8 (Continued)

one (1) per year, or three (3) in two years, and in any event all five (5) photoplays on or before November 1, 1928, said photoplays to be delivered and distributed on the same terms and conditions as are set forth in the original distribution agreement, except:

“(a) Griffith shall receive no additional common stock beyond the amounts provided to be delivered to him during the original term of said contract.

“(b) The provisions of Article IV hereof.”

In case Griffith fails or refuses to become a party to this agreement, and in the event that for any reason whatsoever the corporation distributes his productions in accordance with the provisions of the original agreement between Griffith and the corporation as extended, then, in order that Griffith shall have no preference over any of the other parties hereto, the charge for distribution for each production of the parties hereto shall be the same as for Griffith's productions, and to that end appropriate refund shall be made by the corporation to the other parties to this agreement so that the percentage cost of distribution to them shall be no greater than that paid by Griffith.

Section 2. Nothing herein contained shall be construed in any manner in derogation of the extension agreement heretofore signed by the parties hereto and Griffith, it being the intention of the parties hereto by the execution of this agreement

Petitioner's Exhibit No. 8 (Continued)

to ratify and affirm the execution of said former extension agreement.

ARTICLE VIII.

Section 1. Anything herein to the contrary notwithstanding, Chaplin shall have the absolute right during each year, during the period of five (5) years commencing January 1, 1925, to deliver to the corporation for distribution not more than two (2) pictures in addition to those hereinabove contracted for, upon the same terms and conditions provided in his existing contract with the corporation, as modified by this agreement, except that he shall not be entitled to receive any additional common stock upon the delivery of any such additional pictures, and that he shall not be obligated to appear in, direct or supervise such additional pictures. The provisions of Chaplin's existing contract, as modified by this agreement, shall govern and apply to each additional production in the same manner and to the same extent, and with the same force and effect, as if such productions were specifically mentioned in such agreement as modified, except as aforesaid, and except further, that the corporation agrees to adopt and use upon the main title of such additional productions and upon all paid advertising, publicity and exploitation material such wording, phraseology, and reading matter as may be required by Chaplin.

At least sixty (60) days before the delivery date of any such additional production, Chaplin shall

Petitioner's Exhibit No. 8 (Continued)

give notice by registered mail to each of the parties hereto of his exercise of the privilege to furnish to the corporation for distribution additional productions, and upon the service of such notice, each of the parties hereto, including Schenck individually, shall have a similar right to require the corporation to distribute the same number of productions as Chaplin shall deliver to the corporation for distribution, and upon substantially the same terms and conditions as shall govern and apply to the additional Chaplin productions. Nothing herein contained shall be construed as relieving any of the parties hereto from delivering to the corporation for distribution the number of pictures hereinabove specifically provided for in the other articles.

In the event of the exercise by any of the parties hereto of the rights granted under this article, then the corporation agrees, upon request of such parties, to enter into appropriate distribution contracts with respect to such additional productions.

In Witness Whereof, the parties hereto have executed this agreement the day and year first above

Petitioner's Exhibit No. 8 (Continued)
written, the corporation by its proper officers there-
unto duly authorized.

MARY PICKFORD FAIR-
BANKS

CHARLES CHAPLIN

JOSEPH M. SCHENCK

DOUGLAS FAIRBANKS

UNITED ARTISTS COR-
PORATION

By DENNIS F. O'BRIEN

Vice-President

[Seal of U. A. Corp.]

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: I would like to offer certificates, photostatic copies of certificates, Nos. 83 to 88, inclusive, being six certificates in all of the common stock of United Artists Corporation. Each certificate is dated October 31, 1928, certificate No. 83 being for 166 shares, certificate No. 84 being for 167 shares, certificate No. 85 for 166 shares, certificate No. 86 for 167 shares, certificate No. 87 for 167 shares, and certificate No. 88 for 167 shares. All of these certificates are in the name of Mr. Charles Chaplin, and each is endorsed by Mr. Chaplin.

I offer those as Exhibit No. 9, if the Court please.

Mr. Horner: No objection.

The Court: They may be attached together by the Clerk and received as one exhibit, No. 9.

(The documents, so offered and received in evidence, were marked Petitioner's Exhibit 9, and made a part of this record.)

PETITIONER'S EXHIBIT No. 9

Consists of six common stock certificates, numbered from 83 to 88 inclusive, one of which is set out as follows:

Incorporated under the Laws of the
State of Delaware

No. 83

166 Shares

UNITED ARTISTS CORPORATION

Total Authorized Shares

8% cumulative preferred shares 8000 shares of the
par value of \$100.00 each.

Common shares 9000 shares of no par value

This is to Certify that Charles Chaplin is the owner of 166 common shares of no par value of United Artists Corporation on the books of the Corporation transferable in person or by duly authorized attorney only upon surrender of this certificate duly endorsed and subject to the restrictions and limitations of transferability herein stated. For a statement of the rights, privileges and preferences and voting powers and the restrictions and qualifications of the preferred and common shares

of the Corporation and of the provision for redemption of the preferred shares and the sinking fund therefor reference is made to the Certificate of Incorporation and the By-Laws of the Corporation.

The Board of Directors of the United Artists Corporation on April 24, 1919, adopted a resolution as follows:

“Resolved, That in accordance with the provisions of the Certificate of Incorporation of the Corporation and particularly the Fourth Article thereof and the portion of such Article dealing with transferability of common shares, and in conformity with the By-Laws of the Corporation and particularly the Seventh Article of such By-Laws this Board prescribes the following limitation of transferability as to all common shares of the Corporation authorized, to wit, 9,000 shares; the right of holders of certificates representing such shares or any of them shall be limited in the manner provided in Article Seven of the By-Laws in case any holder of any such certificate representing any of such shares shall at any time desire to sell or give away any share or shares represented by such certificate to any person other than a person at the time actively associated with such share holder in the business of producing photo-plays. This limitation of transferability shall apply not only to each certificate for any of such 9,000 shares originally authorized when issued but to all other certificates for shares thereafter at any time issued against the transfer of such shares.”

Reference is made to such provisions of the Certificate of Incorporation and the By-Laws for a full statement of the limitation of transferability.

In Witness Whereof the Corporation has caused its corporate seal to be hereto affixed and this certificate to be signed by its duly authorized officers this 31st day of October, 1928.

(Signature illegible)

President.

F. A. BEACH,

Asst. Secretary.

For Value Received, hereby sell, assign and transfer unto Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocably constitute and appoint

. Attorney to transfer the said stock on the Books of the within named Corporation with full power of substitution in the premises.

Dated 19

CHARLES CHAPLIN

In Presence of

ALFRED REEVES

Notice: The signature of this assignment must correspond with the name as written upon the face of this certificate in every particular, without alteration, or enlargement or any change whatever.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: I would like to offer as Petitioner's Exhibit No. 10 an agreement dated September 20, 1935, between [65] Charles Chaplin and the United Artists Corporation.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 10, and made a part of this record.)

PETITIONER'S EXHIBIT No. 10

New York, September 20th, 1935.

Mr. Charles Chaplin
Charles Chaplin Studios
Hollywood, California.

Dear Mr. Chaplin:

You and the undersigned, United Artists Corporation, a Delaware corporation, Do Hereby Agree to modify subdivision (i) of Article "Third" of the agreement between us dated the 5th day of February, 1919, reading as follows:

"(i) And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation (*) to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist (**) delivers to said corporation, nine (9) photo-plays. Should said artist be unable to deliver

nine (9) such photoplays because of illness or in capacity during the said entire period of time (3) years, said artist shall receive so many of the aforesaid one thousand (1,000) shares of the common stock of this corporation as the number of photoplays delivered by said artist to this corporation pursuant to this agreement bears to the number of nine. The balance of the shares of such common stock shall be delivered by such escrow agent to this corporation."

(*—"corporation" hereinabove mentioned meaning United Artists Corporation.)

(**—"artist" hereinabove mentioned meaning Charles Chaplin.)

and Section (1) of Article Third of the agreement dated November 22nd, 1924, by and between Mary Pickford Fairbanks of Los Angeles, California, Charles Chaplin, of Los Angeles, Douglas Fairbanks of Los Angeles, Joseph M. Schenck of Los Angeles and United Artists Corporation, a Delaware corporation which reads as follows:

"Section 1. Chaplin and the corporation (*) agree to, and do hereby modify the Chaplin distribution agreement so that Chaplin shall be obligated to deliver to the corporation for distribution only five (5) additional motion picture photoplays, described in the original contract instead of the eight (8) undelivered pictures provided for in said contract. The balance of the common stock of the corporation,

which is now held in escrow for the benefit of Chaplin, shall be delivered to him in the proportion of one-fifth ($1/5$) thereof upon delivery of each motion picture photoplay by Chaplin to the corporation, as in said contract provided. Chaplin agrees to deliver to the corporation not less than one (1) motion picture photoplay per year, commencing at the date hereof, and to deliver all five (5) of said photoplays on or before January 1, 1929. Chaplin also agrees to the provisions of Article IV hereof."

(*—"corporation" hereinabove mentioned meaning United Artists Corporation.)

in so far as the above sections relate to Certificates # 87 and # 88 respectively, each for one hundred sixty-seven (167) shares of the common stock of the United Artists Corporation, issued in the name of Charles Chaplin, dated October 31, 1928, totaling three hundred and thirty four (334) shares common stock of the United Artists Corporation, now held in escrow by Dennis F. O'Brien, Escrow Agent, and the dividends and interest thereon heretofore paid on such stock by the United Artists Corporation, and deposited in a special fund by the United Artists Corporation, together with the accumulated interest thereon, to comply with the following resolution legally adopted at a meeting of the Board of Directors of United Artists Corporation, duly called and held pursuant to the by-laws on the 19th day of August, 1935, at which a quorum of directors was present:

“Resolved, that United Artists Corporation immediately deliver to Charles Chaplin any and all stock of this corporation held in escrow, as well as all dividends escrowed, which stock and dividends have been escrowed pending the delivery of this corporation of further photoplays to be released by the said Charles Chaplin.

Be it further

“Resolved, that the attorneys, officers and agents of this corporation be, and they are hereby instructed to notify the escrow holder of this action of the Board, and instruct him to deliver said capital stock and accumulated dividends to the said Charles Chaplin.

Be it further

“Resolved, that the officers, agents and employees of this corporation be, and they hereby are directed, empowered and instructed to do any and all other things necessary, desirable or requisite to accomplish the purpose of the above resolution.”

and to direct in writing Dennis F. O'Brien, called “Depository” in the agreement dated August 5th, 1919, between United Artists Corporation, Charles Chaplin and Dennis F. O'Brien, as modified in compliance with Section (1) of Article Third of the aforesaid agreement of November 22nd, 1924, to deliver to you in compliance with the above resolution, certificates of common stock of the United Artists Corporation # 87 and # 88 respectively, each for 167 shares common stock, no par value, of

the United Artists Corporation, upon the return to the said Dennis F. O'Brien of the depositary receipts which you now hold relative to the aforesaid certificates of common stock of the United Artists Corporation;

And you and the undersigned, by these presents, have agreed that the aforesaid existing agreements between you and the undersigned, relative to the distribution of the motion picture photoplays produced or to be produced by you and distributed or to be distributed by the undersigned, Are Hereby Modified in conformity with the aforesaid resolution of the Board of Directors of United Artists Corporation, pursuant to which you are entitled to receive from the said depositary Dennis F. O'Brien the aforesaid certificates # 87 and # 88 respectively, totaling 334 shares of the common stock, no par value, of the United Artists Corporation, and the dividends heretofore paid on account of such stock and deposited in a Special Account by the United Artists Corporation, together with the interest accumulations upon the same;

Subject to your delivering to the said Depositary Dennis F. O'Brien, the depositary receipts that you now hold evidencing the depositary's receipt of such stock pursuant to said depositary agreement, and the delivery of a duly executed copy of this agreement between the parties hereto, to said depositary Dennis F. O'Brien;

And that except as herein modified, to wit, providing for the delivery to you of the aforesaid shares of stock and the dividends heretofore paid

thereon and the interest accumulations thereon, as herein provided, instead of upon the delivery by you of the fifth and sixth motion picture photo-plays respectively to the United Artists Corporation for distribution under the existing contracts between you and the undersigned, the aforesaid agreements, including the paragraphs herein modified shall remain in full force and effect.

In Witness Whereof, the undersigned, United Artists Corporation, a Delaware corporation, has caused this instrument to be executed by its duly authorized officer and you by your signature under the word "Agreed", below, have accepted and agreed to the aforesaid.

Very truly yours,

UNITED ARTISTS CORPORATION,

By A. LICHTMAN,

Pres.

Agreed:

CHARLES CHAPLIN.

New York, September 20th, 1935.

Dennis F. O'Brien, Esq.,

Depository,

152 West 42nd Street,

New York.

Dear Sir:

We, the undersigned, Charles Chaplin, and United Artists Corporation, a Delaware corporation, Do Hereby Direct You to deliver to Charles Chaplin the following described certificates:

87 for 167 shares common stock, no par value, of United Artists Corporation, a Delaware corporation, dated October 31st, 1928;

88 for 167 shares common stock, no par value, of United Artists Corporation, a Delaware corporation, dated October 31st, 1928;

both issued in the name of Charles Chaplin, upon the delivery to you by Charles Chaplin of the depositary receipts evidencing your receipt of the aforesaid shares of common stock of the United Artists Corporation, and upon such delivery by you of the above certificates to Charles Chaplin, we Do Hereby Terminate such depositary agreement and release you from any and all claims of any and all kind or character on behalf of each or both of us, and to save you harmless in the premises.

Yours very truly,

CHARLES CHAPLIN

UNITED ARTISTS CORPORATION,

By A. LICHTMAN,

Pres.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

The Court: Call your witnesses.

Mr. Horner: May I just interrupt you a moment?

The Respondent has an amended answer with an accompanying motion, which is agreeable to the

Petitioner, and I wondered if your Honor would permit me to file it at this time?

The Court: Any objection?

Mr. Green: No objection, your Honor.

The Court: Very well. It may be handed to the Clerk and will be filed. Is it necessary for a reply to be filed?

Mr. Green: I don't believe so, your Honor.

The Court: Very well.

Mr. Green: Mr. O'Brien.

DENNIS FRANCIS O'BRIEN

a witness on behalf of Petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Green) Mr. O'Brien, will you state your full [66] name?

A. Dennie Francis O'Brien.

Q. And where do you reside?

A. 125 Walter Avenue, Yonkers, New York State.

Q. And what is your business or occupation?

A. Practitioner of law.

Q. And how long have you been admitted to practice law? A. Since 1901.

Q. What firm are you a member of, Mr. O'Brien?

A. The firm is O'Brien, Molevinsky and Driscoll. With the death of Mr. Molevinsky about ten years ago we became O'Brien, Driscoll and Raftery.

Q. What experience, Mr. O'Brien, have you had

(Testimony of Dennis Francis O'Brien.)

in connection with the motion picture theatrical business?

A. Well, the theatrical business preceded, as you understand, the motion picture business. I started in 1905 being active in the law of the theatre with George Cohan, my first client, and I have been active with him ever since.

Shall I go forward?

Q. Yes, please.

A. In 1906—in 1905 I came to New York City and became general counsel of the People's Security Company, which was an organization that represented the labor unions quite in the same way as casualty companies represented the employers. In other words, we took the plaintiff's end and acted in [67] suits. Upon completing my engagement there, I opened my own law office in the Times Building in Times Square in 1906, and, as I stated, Mr. Cohan was my first client.

Following that it became the firm of Cohan and Harris, and I represent each and both of them ever since that period. They were for a long number of years the most active and most successful producers of theatrical entertainment in America.

At and about the time that the copyright law of 1908 which had been before Congress for many years, and was then before the patent committee of the House of Representatives, I represented at all the hearings in connection with that bill, which subsequently became a law, the part of a number of

(Testimony of Dennis Francis O'Brien.)

authors, composers, and others who would be affected by the copyright law.

And it was passed—I think it was the last act of the President that it was signed—in 1908. From that time on we have been very active in matters pertaining to copyright in the courts and otherwise.

Shortly thereafter I became attorney for what was known as the White Rats actors' organization, which was the organization of vaudeville performers, and I represented them for ten years. Their average membership, which included, of course, the foreign performers—that is where I first met Mr. Chaplin, one night in a London music hall, through [68] the connection between the White Rats and the Variety Artists Federation of London, and also the Artischenoss in Germany, and the Lyric Society of France—that membership would average, I would say, in the neighborhood of 10,000 a year, and we looked after their theatrical and business affairs pretty much all throughout America, having associates in various parts of the United States.

Following that I became attorney for the Actors' Society of America, the forerunner of Equity, and served there for a number of years. Thomas A. Wise was president most of the time. And pursuant to that I became attorney for the Authors, for the Society of Authors and Producers—I may not get the names of these societies correct—which was founded by Bronson Howard and who left an endowment for it. During that period I drafted and

(Testimony of Dennis Francis O'Brien.)

introduced into Albany and followed the travel of a theatrical employment agency act which we sought to correct the abuses in contracts that had to do with the employment of actors and actresses and particularly as regards the commissions to be paid. That was finally passed.

About that time pictures came in, and for a number of years we represented many of the picture actors before they ever came out here. For instance, Miss Pickford was one of our most important clients. We represented her, or I did, from the time that she started with Mr. Zukor, and her [69] first contract was a salary contract pursuant to which acting under our advice we believed her position sufficiently strong so that it was changed into a participating in the ownership and owning half of the stock of the operation. And we continued under that—that representation was continued until her contract was finally finished with Mr. Zukor and his associates when she came out here and produced three pictures for First National. We continued to represent her and would come out on business matters for her.

I had a similar representation of Douglas Fairbanks, starting with him when he first went into pictures. In fact, I negotiated his first contract in New York and organized the Douglas Fairbanks Pictures Corporation and acted as an officer and a member of the board of directors and attorney for it. And we represented a great many other motion picture actors, including Richard Barthelmess and

(Testimony of Dennis Francis O'Brien.)

Richard Dix, and I would say a large portion of the various actors and actresses who were members of these organizations. And it was really through that connection that we were representing them.

That brings us up to about the time when the United Artists was formed.

Q. In 1919 when the United Artists was formed you represented Miss Pickford at that time, did you not?

A. An also Douglas Fairbanks. [70]

Q. And you knew Mr. Chaplin at that time?

A. I did.

Q. And at that time did you know D. W. Griffith?

A. Very well.

Q. What was his business in the motion picture industry?

A. D. W. Griffith was perhaps the longest and most successful well known director of motion pictures. Miss Pickford was originally with him down on 26th Street.

Q. Now, did you participate in any way as an attorney, Mr. O'Brien, in the organization of United Artists Corporation?

A. I did all of the way through it.

Q. Did you participate in the conferences and in the negotiations that led up to the formation of United Artists Corporation?

A. I did.

Q. Mr. O'Brien, I will show you a document entitled "Declaration of Independence" signed January 15, 1919, by Mary Pickford, William S. Hart, Douglas Fairbanks, Charlie Chaplin, and D. W.

(Testimony of Dennis Francis O'Brien.)

Griffith. I will ask you the circumstances under which that document was signed.

A. (Examining document) There had been great dissatisfaction among the persons, particularly the stars, who had won a great following and whose names meant a large return to the box office over the methods that were being pursued [71] in connection with the marketing and selling of their motion pictures. And I had been out here to complete a negotiation started in New York with Mr. Zukor for Douglas Fairbanks.

We had a distinct understanding—it was in the contract—that the Fairbanks pictures, which were being distributed by the same corporation as the Pickford pictures and certain pictures that George Cohan had made—I represented all three—that they would be sold by this separate corporation and sold separate alone and free of any connection with any other pictures, such as program pictures, which was more or less the forerunner of the block system of selling. And we had that understanding. We really did not know who owned this corporation, and we discovered later as the contract went forward that it was owned by Paramount. Paramount had been a name used by a group of distributors who zoned pictures. I mean by that that they acquired exclusive franchises to sell pictures in certain definite parts of the United States. They would own the picture exclusively for that particular section. And they sold a great many pictures, and, naturally, they used one picture to sell another. So

(Testimony of Dennis Francis O'Brien.)

we wanted to have, at least I say "we," pardon me, the producers wanted to have that, which they regarded as illegal, corrected.

They also wanted to be free to determine the choice of [72] their subjects and the amount of money they would spend, and how the pictures would be marketed, and the elements that go into the selling of the picture and the exploitation of the picture.

All my recollection is that the representatives of the First National here, or the representatives of the so-called Zukor crowd, which at that time had been—that was the Famous Players Corporation, which was his corporation and his associates—and the Jesse L. Lasky Pictures Corporation, and they had been merged. Then finally both of those were merged into the Paramount, which was a distributing company and which had been acquired by substituting stock or, rather, paying stock for the so termed franchises of various territories, and got these owners of the franchises interested in Paramount as stockholders, not as managers of these different territories.

Q. So this declaration of independence which these individuals signed was an announcement to the world, was it not, that they were associating themselves together to produce and distribute their own pictures?

A. They were doing that to protect themselves against what they thought were evils of the business.

(Testimony of Dennis Francis O'Brien.)

Q. I noticed this was signed by William S. Hart. Did Mr. Hart actually come in and participate in the new corporation? [73]

A. He participated in negotiations, but he did not join.

Mr. Green: I would like to offer in evidence as Petitioner's Exhibit No. 11, your Honor, this document.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 11, and made a part of this record.)

PETITIONER'S EXHIBIT No. 11

Declaration of Independence

A new combination of Motion Picture stars and producers was formed yesterday, and we the undersigned in furtherance of the artistic welfare of the moving picture industry, believing we can better serve that great and growing interest in picture productions, have decided to unite our work into one association; and at the finish of existing contracts, which are now rapidly drawing to a close, to release our combined productions through our own organization. This new organization to embrace the very best actors and producers in the motion picture business—headed by the following well known stars: Mary Pickford, William S. Hart,

(Testimony of Dennis Francis O'Brien.)

Douglas Fairbanks, Charles Chaplin, and the D. W. Griffith productions, all of whom have proven their ability to make productions of value, both artistically and financially.

We believe this is necessary to protect the exhibitor and the industry itself, thus enabling the exhibitor to book only pictures that he wishes to play and not force upon him, (when he is booking films to please his audience) other program films which he does not desire. Believing that as servants of the people, we can thus best serve the people. We also think that this step is positively and absolutely necessary to protect the great motion picture public from threatening combinations and trusts that would force upon them mediocre productions and machine made entertainments.

Dated at Los Angeles, Cal., Jan. 15, 1919.

MARY PICKFORD

WILLIAM S. HART

DOUGLAS FAIRBANKS

CHARLIE CHAPLIN

D. W. GRIFFITH

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Q. (By Mr. Green) Mr. O'Brien, under what state was United Artists incorporated?

A. The State of Delaware.

Q. I call your attention to Petitioner's Exhibit

(Testimony of Dennis Francis O'Brien.)

1, which provides that, on page 2, the corporation shall be organized pursuant to the laws of the State of New York. I will ask you why when the corporation was actually organized it was organized under the laws of the State of Delaware.

A. Because Mr. Joseph F. Cotton, who was representing Mr. McAdoo, desired the corporation to function under the laws of Delaware, so to be sure there would be no question as to the proper consideration paid for the issuance of the stock, he wanted that absolutely clear. He wanted the title of the stock in so far as Mr. McAdoo's 1,000 shares was concerned to be without any question. There was some doubt about the laws of the State of New York inquiring into the propriety and accuracy of consideration. [74]

Q. Yes. Mr. O'Brien, who actually as the attorney had charge of the incorporating of United Artists Corporation?

A. Mr. Joseph F. Cotton, Joseph P. Cotton.

Q. With whom was he associated?

A. He was associated with Mr. McAdoo. Our original, as the papers will show, was negotiated with Mr. McAdoo personally, and then Mr. Cotton and Franklin came out, and the firm of McAdoo, Cotton and Franklin was substituted for Mr. McAdoo.

Q. And did Mr. McAdoo receive any shares of stock of United Artists?

A. He received 1,000 shares, one-fifth of what had been voted out to the four incorporators and

(Testimony of Dennis Francis O'Brien.)

the four people who were going to make pictures. They gave him one-fifth of their stock.

Q. Did Mr. McAdoo receive shares of common or preferred stock? A. Common.

Q. And I will show you Petitioner's Exhibit 1, which provides for the issuance of 1,000 shares of common stock of the United Artists Corporation to Mr. Chaplin, Miss Pickford, Mr. Fairbanks, and Mr. Griffith. Now, it also provides for the issuance of 1,000 shares of the common stock to William G. McAdoo, "who is to become general counsel of said corporation." I will ask you what is the consideration for the issuance of those 5,000 shares of common stock?

A. It is the consideration that is set forth in the minutes of the first meeting, which I acted as secretary, if I remember correctly, and it was the delivery of the contract; not the fulfillment.

And the bylaws are all drawn in keeping with that basis and that theory.

Q. Now, the contract to which you refer is Petitioner's Exhibit No. 5, which was executed on February 5, 1919, is that right?

A. (Examining document) Executed afterwards. Yes.

Q. And that document was executed by Mr. Chaplin on February 5, 1919, and afterwards accepted and executed by United Artists on June 13, 1919, is that right? A. That is right.

Q. Now, I will show you here Petitioner's Exhibit No. 4, which is nine certificates of the common

(Testimony of Dennis Francis O'Brien.)

stock of United Artists Corporation, all dated June 9, 1919, and all in the name of Mr. Charles Chaplin, making a total of 1,000 shares evidenced by these certificates. I will ask you if those are the 1,000 shares of stock, common stock, that were issued to Mr. Chaplin pursuant to this agreement of February 5, 1919. A. They are. [76]

Q. And are those the 1,000 shares of stock that were issued to Mr. Chaplin as consideration for the execution of the agreement of February 5, 1919?

A. That is my understanding.

Q. And that is Petitioner's Exhibit No. 5 in this case? A. Yes.

Q. And I call your attention to the fact that the certificate reads in part as follows: "This is to certify that Charles Chaplin is the owner of"—in each case the number of shares represented by the certificate. I will ask you when did Mr. Chaplin actually become the owner of those shares of stock.

Mr. Horner: If the Court please, I object to that question as a conclusion of the witness. That is the very controversy in this case.

The Court: The objection will be sustained.

Mr. Green: If the Court please, may I be heard on that?

The Court: You may.

Mr. Green: If the Court please, the witness in this case represented part of the parties to the original organization of United Artists Corporation. As I will bring out in a few moments, he was general counsel for the corporation from 1920 down

(Testimony of Dennis Francis O'Brien.)

to the present date. He was also the escrow holder who took these particular shares of stock and [77] held them in escrow pursuant to the agreement of August 5, 1919, which is Petitioner's Exhibit No. 7. He was a director of the corporation, and he was also an officer of the corporation during most of the period of time that it has been in existence. Consequently, both by reason of the fact that he was the attorney for the corporation, and by reason of the fact that he was the escrow holder, by reason of the fact that he was an officer of the corporation, it is our contention that he was in a position to know who the stockholders were and when they became stockholders. Further than that, if your Honor please, I would like to call your Honor's attention to the case of Nolen vs. Nolen, 155 Cal. 477, which is authority for the fact that a witness in a proceeding is entitled to be asked who was the owner of certain property even though the witness himself is not a party to the proceeding. In this particular case, the plaintiff's daughter was on the witness stand in this Nolen case and she was asked this question: "Is this note not your own property?"

"A. It is.

"Q. Did you ever own it? A. I never did.

"Q. Do you know who owns it?

"A. My father does."

The appellant on appeal argued that the foregoing questions called for the opinions or conclusions of the [78] witness and not for the facts. The Court said: "Of course, there is no general rule of evi-

(Testimony of Dennis Francis O'Brien.)

dence which permits a witness to substitute opinions for facts. The true rule is simple and so far as this case is concerned is well established. To permit or to refuse to permit such questions is a matter resting largely in the discretion of the trial Court, which discussion will not here be reviewed unless it is made plain that the Court's ruling in admitting the evidence has worked an injury. Generally speaking, the admission of the answer to such a question cannot work an injury where a fair latitude on cross examination is allowed, for under such cross examination the facts are certain to be adduced. It will be found frequently that an appellate tribunal upholds the rulings of questions, but the cases are far less numerous where it has felt compelled to reverse the inferior tribunal for permitting that."

If the Court please, by reason of this authority and by reason of Mr. O'Brien's connection with this particular corporation throughout its existence from the very beginning, I contend that the question is proper and he is a proper witness to answer the question.

The Court: Well, we are bound by the rules of evidence as they exist in the courts of equity in the District of Columbia. Therefore your **California** citation is not particularly helpful. The general rule of evidence, as I [79] understand it, is that the witness shall give us the facts and we shall make the determination as to the ultimate question. If, therefore, it is the issue in this case whether Mr.

(Testimony of Dennis Francis O'Brien.)

Chaplin was or was not the owner of the stock, the witness' statement one way or the other wouldn't be particularly helpful, and I think would be wholly immaterial what he thinks about it. He can give us all the facts, and we will determine the question itself.

So the ruling will be adhered to. You may have an exception. The objection will be sustained.

Mr. Green: Thank you, your Honor.

Q. Mr. O'Brien, are you the party who was designated as escrow holder under the agreement of August 5, 1919, which is Petitioner's Exhibit 7 in this case?

A. I think I am a depositary. That was the term used.

Q. Would you like to see it?

I will show you a conformed copy of an agreement of August 5, 1919, between United Artists Corporation, Charles Chaplin, and Dennis F. O'Brien. Are you the Dennis F. O'Brien that is referred to in that agreement?

A. (Examining document) I am.

Q. That agreement was actually executed on the date it bears? A. That is my recollection.

Mr. Horner: Mr. Green, what exhibit, please?

[80]

Mr. Green: No. 7, Mr. Horner.

Mr. Horner: Thank you.

Q. (By Mr. Green) Paragraph first of this agreement provides: "That there shall be delivered to you and deposited with you nine certificates of

(Testimony of Dennis Francis O'Brien.)

stock evidencing 1,000 shares of common stock of the United Artists Corporation."

Were those shares of stock actually delivered to you, Mr. O'Brien? A. They were.

Q. And are they the ones that are evidenced by Petitioner's Exhibit No. 4 in this case?

A. They are.

Q. And you took those certificates and held them as escrow holder pursuant to this agreement?

A. I did.

Q. Do you recall on what date you actually received the certificates, Mr. O'Brien?

A. It was in September. There was some delay, and all were delivered to me at one time. I have a letter from Oscar A. Price, a copy of which I have here, if you care to see it, that evidences the date.

May I refresh my recollection as to that date? (Examining document.)

The date is September 8, 1919. [81]

Q. And I will ask you if at the time these certificates were delivered to you as depositary under the agreement of August 5, 1919, if they were endorsed by Mr. Chaplin.

A. They were not endorsed.

Q. Were they ever endorsed at any time?

A. Not those.

Mr. Horner: You then refer to Exhibit 4?

Mr. Green: Yes.

Q. Mr. O'Brien, did you continue to hold those shares of stock evidenced by Petitioner's Exhibit 4 in escrow pursuant to the escrow agreement?

(Testimony of Dennis Francis O'Brien.)

A. I did.

Q. And until the certificates were finally released from the escrow holder you remained escrow holder at all times, did you not? A. I did.

Q. Was there any change to your knowledge in the ownership of the shares of stock evidenced by Petitioner's Exhibit No. 4 during the period from September 8, 1919, when you first received them, until the final termination of the escrow agreement and the release of the final certificates, 1935?

Mr. Horner: If the Court please, I think that is objectionable. It is attempting, it seems to me, to go in the back door when your Honor has ruled him out of the [82] front door.

The Court: I don't think it would be particularly helpful. The question is whether there was a change in ownership.

Mr. Green: That is right.

Mr. Horner: That, your Honor, it seems to me, contemplates the necessity first for Mr. O'Brien to determine who the original owner was before he could say whether there was a change.

The Court: It wouldn't do any harm for the witness to give his opinion, but, of course, as I have stated, we would not feel ourselves bound or conclude by his testimony that the ownership was thus and so or that there was a change in ownership or not. That would be a legal conclusion by the witness which would not be binding upon us. If you insist on him answering such a question, of course, it is subject to that effect. That is the only effect

(Testimony of Dennis Francis O'Brien.)

it would have. Now, if he gives us the facts, we can determine the ultimate question, theoretically, better than he can. That is the reason we are here. That is the thing that we are to try. I think, however, I will permit him to answer the question because of the way it is phrased, as to whether or not he knew of any change in ownership. That is how you asked the question?

Mr. Green: Yes, your Honor. [83]

The Court: So he may answer that question.

The Witness: I do not know of any change.

Q. (By Mr. Green) Mr. O'Brien, I will show you a form of certificate of deposit, and I will ask you if you can identify that document.

A. (Examining document) That is the copy of what was used in connection with the depositary agreement and the reception of the stock by me, yes.

Q. In other words, after the stock was received by you in escrow, you issued a certificate of deposit in this form? A. Yes, I did.

Q. And an original certificate of deposit evidencing the 1,000 shares of common stock issued to Mr. Charles Chaplin evidenced by Petitioner's Exhibit 4 was executed by you, was it not?

A. It was.

Q. And delivered to Mr. Chaplin?

A. It was.

Q. Or his attorney?

A. It was delivered to every one of the stockholders.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: I would like to offer this in evidence, if the Court please, as Petitioner's Exhibit No. 12.

Mr. Horner: No objection.

The Court: It will be received. [84]

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 12 and made a part of this record.)

PETITIONER'S EXHIBIT No. 12

EXHIBIT "A"

Certificate of Deposit.

No.

No. of Shares

Certificate of
Deposit

representing the Common Stock of United Artists Corporation.

This Is To Certify that there have been deposited with Dennis F. O'Brien (herein called the "Depository"), under a written agreement, dated 1919, (a copy of which is on file at the office of Depository), for the benefit of Charles Chaplin (herein called the "Beneficiary"), nine (9) stock certificates representing in the aggregate one thousand (1000) shares of common stock of United Artists Corporation, without par value, and that under said agreement the Beneficiary will be entitled to a delivery of said stock

(Testimony of Dennis Francis O'Brien.)

certificates or some portion thereof upon surrender hereof and upon receipt by the Depositary of a written notice from United Artists Corporation that the Beneficiary is entitled thereto under the terms of said agreement.

The holder of this certificate of deposit shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Q. (By Mr. Green) Mr. O'Brien, I will show you a photostatic copy of a stock ledger sheet. It shows the name of Charles Chaplin, and I will ask you if that is a photostatic copy of the stock ledger sheet of the United Artists Corporation.

A. (Examining document) I would say that it is.

Q. Now——

A. (Interrupting) I got it from the treasurer before I came out, and I saw the bulletin and saw the copy.

Q. Now, this stock ledger sheet shows that on June 9, 1919 there was issued to Mr. Charles Chaplin 1,000 shares of common stock of United Artists Corporation, does it not?

A. (Examining document) It does.

Q. And are those 1,000 shares of common stock the 1,000 shares which are evidenced by Petitioner's Exhibit No. 4 in this case? A. They are.

(Testimony of Dennis Francis O'Brien.)

Q. And this document also shows any re-issuance of those shares of common stock, does it not?

A. It does.

Q. At any time subsequent to June 9, 1919?

A. It does, when they are changed to 166 and 167 shares per [85] certificate as you have already offered in evidence.

Q. That change was on October 31, 1928, was it not?

A. Yes.

Q. And at that time the 1,000 shares of stock evidenced by Petitioner's Exhibit No. 4 were delivered back to United Artists Corporation and cancelled?

A. Yes.

Q. And in turn the United Artists Corporation issued six certificates totaling 1,000 shares, did it not?

A. That is correct.

Q. And those six certificates were delivered to you in escrow as escrow holder?

A. Well, I—yes, that is right, because Mr. Chaplin—well, he had "The Woman of Paris" for which he had received 112 shares, and then came back the 112, and I handed it back as depositary, the balance between 900 and the 112, and these new certificates were issued.

Q. Now, I will ask you, after these new certificates were issued which are Petitioner's Exhibit 9 in this case, did you shortly after October 31, 1928, deliver to Mr. Chaplin any of the certificates which you were then holding in escrow?

Mr. Horner: May I have that question read, Mr. Reporter?

(Testimony of Dennis Francis O'Brien.)

(The question referred to was read by the reporter, [86] as set forth above.)

The Witness: I did.

Q. (By Mr. Green) Mr. O'Brien, do you know how many certificates of stock you delivered to Mr. Chaplin at that time?

A. The record shows. I think it was two. He had delivered two pictures to the United Artists for which he hadn't received the stock that was to be released upon the delivery of the pictures.

Q. And those pictures were "The Gold Rush" and "The Circus," were they not?

A. That is right.

Q. And they had been completed and delivered to United Artists prior to that time?

A. That is right.

Mr. Horner: Prior to what time, Mr. Green?

Mr. Green: To this date.

Mr. Horner: That is, prior to October, 1928?

Mr. Green: Yes.

Mr. Horner: All right.

Q. (By Mr. Green) And these two certificates actually were delivered to Mr. Chaplin on or about November 8, 1928, were they not?

A. That is the date there, yes.

Q. Mr. O'Brien, I will show you Petitioner's Exhibit No. 9, [87] which is six photostatic copies of stock certificates Nos. 83 to 87, inclusive, of United Artists Corporation, evidencing shares of common stock issued to Mr. Charles Chaplin under date of October 31, 1928, and I will ask you if those

(Testimony of Dennis Francis O'Brien.)

are the six certificates that you have just testified to as having been issued on that day.

A. (Examining document) They are.

Q. And are they the certificates that are shown upon this ledger sheet as having been issued on October 31, 1928?

A. That is the date of the certificates, yes.

Q. Yes. Now, it was two of these certificates that you delivered back to Mr. Chaplin on November 8, 1928, was it?

A. That is correct.

Q. And those two were for the pictures "The Gold Rush" and "The Circus"?

A. That is right.

Q. And he also received back one of these certificates for "The Woman of Paris"?

A. That is right.

Q. So thereafter you continued to hold three certificates of stock in escrow?

A. Yes.

Q. Mr. O'Brien, do you have there a record of the actual—of the numbers of these certificates that were actually [88] delivered to Mr. Chaplin on November 8, 1928?

A. '28?

Q. Yes. I call your attention to the document you have there which I believe gives the release date on each of those pictures.

A. (Examining document) "Woman of Paris," November 4, 1923; "The Gold Rush," August 16, 1925; "The Circus," January 7, 1928; "City Lights," March 1, 1931.

Q. Now, those are the dates that those particular

(Testimony of Dennis Francis O'Brien.)

pictures were delivered to United Artists Corporation by Mr. Chaplin, were they not?

A. That is the record we have in the office.

Q. Yes. Now, I call your attention here to page 2, which recites that——

A. (Interrupting) "February 2, 1940, received of Dennis O'Brien, depository, three certificates of United Artists."

Q. This date of February 2, 1940, is an entry of your own?

A. That was examined by Mr. White here.

Q. This document shows it is to be dated November 8, 1928.

A. That is it. November 8, 1928.

Q. And that shows that on that date you delivered to Mr. Chaplin certificate No. 83 for 166 shares, which is for the "Woman of Paris," was it not?

A. That would be it, yes. [89]

Q. And you also delivered to him certificate No. 84 for 167 shares which would be for "The Gold Rush," would it not?

A. That is right.

Q. And you also delivered to him certificate No. 85 for 166 shares, which would be for "The Circus," would it not?

A. That is right.

Q. And those three certificates are a part of Petitioner's Exhibit 9, are they not, in this case?

A. I believe so. You introduced them.

Q. I show you Petitioner's Exhibit No. 9, Mr. O'Brien, and ask you if——

A. (Interrupting) What are the dates on it?

(Testimony of Dennis Francis O'Brien.)

Q. October 31, 1928. A. Yes.

Q. So the certificate Nos. 83, 84 and 85 which are a part of Petitioner's Exhibit No. 9 are the three certificates that you actually delivered to Mr. Chaplin on November 8, 1928?

A. That is correct.

Mr. Green: I would like to offer this photostatic copy of the United Artists Corporation journal in evidence as Petitioner's Exhibit No. 13.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 13, and made a part of this record.) [90]

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 13

(Copy)

THE CORPORATION TRUST COMPANY

Name—Charles Chaplin

Address—Los Angeles, Calif.

COMMON

	Date	Folio	Certificates	Dr.	Cr.	Cr. Balance
	1919					
June	9		19			
			20-1-2-3)			
			4-5-6)		888	
	9		27		112	
	1928					
Oct.	31		19-26	888		
	31		27	112		
	31		83		166	
	31		84		167	
	31		85		166	
	31		86)			
			7-8)		501	
	1936					
Dec.	21		3		1000	
	21		8		3000	
	21		83	166		
	21		84	167		
	21		85	166		
	21		86-88	501		
Forward						4000

(Testimony of Dennis Francis O'Brien.)

PREFERRED

Date	Folio	Certificates	Dr.	Cr.	Cr. Balance
1919					
May 12		2		150	
Aug. 8		5		150	
1927					
Dec. 20		22		700	
1929					
June 26		22	700		
26		26		367	
Nov. 1		2	150		
1		5	150		
1		26	367		
Forward					0

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Q. (By Mr. Green) Mr. O'Brien, I will show you an extract from the journal of United Artists Corporation, page 4, which is dated June 9, 1919, at the top, and over in the body of the document it says, "June 9, Artists contracts, \$25,000," and I will ask you if that is a correct extract from the journal of United Artists Corporation of that date.

A. (Examining document) It is.

Q. And where it refers to "artists contracts, \$25,000," I will ask you to what contracts that refers.

A. (Examining document) For the delivery of the photoplays for the corporation.

Q. Yes. But the actual contracts there that that refers to would be the distribution contracts that

(Testimony of Dennis Francis O'Brien.)

United Artists Corporation entered into with Mr. Chaplin, Miss Pickford, Mr. Fairbanks and Mr. Griffith, would they not? A. That is right.

Q. And Petitioner's Exhibit No. 5 here is one of those agreements, is it not?

A. (Examining document) 5th day of February, 1919, yes.

Q. Now, this document, reading on, says, "Consideration for contracts with the four artists for delivery of photoplays to corporation as per resolution of the board of directors of May 29, 1919."

A. That is right. [91]

Q. And it also shows capital stock common issued 5,000 shares at no par value, but regarded as having a value of \$5 per share, does it not?

A. That was the final entry.

Q. So that is the entry that United Artists Corporation made in its journal at the time those contracts were signed, is it not?

A. With the addition of verbal advice of general counsel, which is at the bottom of it. That was Mr. Cotton.

Q. Now, 1,000 shares of those 5,000 were issued to Mr. McAdoo? A. That is right.

Q. And that was in partial consideration for the procuring and execution of these artists' contracts, was it not, distribution agreement?

A. I wouldn't say that.

Q. Mr. O'Brien, I will ask you then——

Mr. Horner (Interrupting): I didn't catch the answer.

(Testimony of Dennis Francis O'Brien.)

The Witness: I wouldn't say it was that.

Q. (By Mr. Green) What would you say was the consideration for the issuance of 1,000 shares of stock to Mr. McAdoo?

A. It was what the four artists agreed to give him, one-fifth of their common stock, which they did, as and when the stock was issued. He got his stock directly. Then in the [92] same meeting we voted, we directors,—I participated—to employ the law firm of McAdoo, Cotton and Franklin for the current year—we weren't even functioning—and pay them \$50,000 as well as additional compensation for additional work outside of what followed to the retainer.

Q. The 1,000 shares of common stock went to Mr. McAdoo alone and not to his firm, did it not?

A. That is right.

Mr. Green: I would like to offer this extract from the United Artists Corporation journal—it shows an entry of June 9, 1919 as an entry—as Petitioner's Exhibit 14.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 14, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 14

Extract from United Artists Corp.

Journal—June, 1919—Page #4

June 9	Artists' Contracts.....A-4	\$25,000.00
	Consideration for contracts with the four artists for delivery of photoplays to Corporation as per resolution of Board of Directors adopted May 29, 1919 (ratified by stockholders Sept. 9, 1919)	
	Capital stock—Common..C-7	\$25,000.00
	Issued 5,000 shares at no par value, but regarded to have a value of \$5.00 per share (verbal advice of General Counsel)	

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Q. (By Mr. Green) Mr. O'Brien, I will show you a document here. It says, "Re common stock United Artists Corporation." Over at the left, "Picture title." In the center of the page, "Release date," and over at the right, "Number of shares."

Now, the first title is Mary Pickford, and under her name—under the title "Picture Title," are the following: "Pollyanna," "Suds," "Love Light," "Through the Back Door," "Little Lord Fauntle-

(Testimony of Dennis Francis O'Brien.)
roy," "Tess of the Storm," "Rosita," [93] "Dorothy Vernon," and "Little Annie Rooney."

I will ask you if those were pictures that were produced by Miss Pickford. A. They are.

Q. And were they actually delivered to United Artists Corporation by Miss Pickford for release on or about the release date shown on this document? A. They were.

Q. And were those the nine pictures which Miss Pickford delivered to United Artists Corporation under her distribution agreement?

A. They are.

Q. And over at the right it shows "Number of shares." Opposite the first eight pictures it shows "111 shares per each picture," and opposite the ninth it shows 112 shares, making a total of 1,000 shares. I will ask you if you also held those shares of stock in escrow. A. I did.

Q. And were they released to Miss Pickford at or about the time that she released these particular pictures? A. They were.

Q. And Miss Pickford was to produce her nine pictures under the agreement that she entered into with United Artists Corporation on February 5, 1919, within a period of three years also, was she not? [94] A. That is correct.

Q. Now, I call your attention to the pictures "Dorothy Vernon," which shows a release date of August 3, 1924, and "Little Annie Rooney," showing a release date of October 19, 1925. Those

(Testimony of Dennis Francis O'Brien.)

pictures were delivered to United Artists Corporation after the expiration of the three year period called for in her agreement?

A. That is correct.

Q. But you actually did, nevertheless, deliver to her on August 3, 1924, a certificate for 111 shares and on October 18, 1925, a certificate for 112 shares, did you not? A. That is correct.

Q. Now, the next title is "Douglas Fairbanks," and under "Picture Title," it has these pictures: "His Majesty the American," "When the Clouds Roll By," "The Mollycoddle," "The Mark of Zorro," "The Nut," "The Three Musketeers," "Robin Hood," "Thief of Bagdad," "Don Q, Son of Zorro." I will ask you if Mr. Fairbanks produced those nine motion pictures. A. He did.

Q. Were those pictures produced by Mr. Fairbanks pursuant to the agreement of February 5, 1919? A. They were.

Q. And were they delivered to United Artists Corporation for release pursuant to that agreement? [95] A. They were.

Q. And were they released by Mr. Fairbanks to United Artists Corporation on or about the release date that this document shows?

A. That is my recollection.

Q. Now, under "Shares" here, it also shows that you delivered to Mr. Fairbanks one certificate of stock for 111 shares at the time he released each of the first eight pictures, is that correct?

(Testimony of Dennis Francis O'Brien.)

A. That is correct.

Q. And you delivered to him the ninth certificate for 112 shares when he released the last picture, "Don Q, Son of Zorro"?

A. That is right.

Q. Now, I call your attention to the fact that pictures 8 and 9, "The Thief of Bagdad" and "Don Q, Son of Zorro," were delivered on December 25, 1924 and August 30, 1924, respectively, is that correct?

Mr. Horner: '25.

The Witness: Yes.

Q. (By Mr. Green) And I will ask you if those two pictures weren't delivered after the expiration of the three year period in Mr. Fairbank's contract of February 5, 1919, with United Artists Corporation.

A. That is my recollection. [96]

Q. But nevertheless when he delivered those pictures, you did release to him the shares of stock?

A. I did.

Q. Set forth in this document? A. Yes.

Q. Next, under "D. W. Griffith"—

The Court (Interrupting): Do you propose to introduce this schedule in evidence?

Mr. Green: Yes, your Honor.

The Court: Let's mark it and receive it and not read it all into the record.

Mr. Green: Very well.

If the Court please, I would like to refer to Mr.

(Testimony of Dennis Francis O'Brien.)

Chaplin's particular pictures, since they are only four, in length.

The Court: You may refer to it at any length you desire. Proceed. I am not telling you how to try your case, but it might shorten it if we might simply receive the exhibit.

Mr. Green: Thank you.

Q. Mr. O'Brien, the document shows that "The Woman of Paris" was delivered on November 4, 1923, is that correct? A. Yes.

Q. And at that time the three year period in Mr. Fairbanks' contract under which he was to deliver nine pictures had already expired, had it not?

[97]

A. You mean Mr. Chaplin?

Q. Mr. Chaplin. Yes.

A. That is correct.

Q. So that within a three year period called for in Petitioner's Exhibit 5 Mr. Chaplin had not delivered a single picture to United Artists Corporation? A. That is right.

Mr. Green: I would like to offer this in evidence as Petitioner's Exhibit No. 15.

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 15, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 15

Re Common Stock—United Artists Corporation

MARY PICKFORD

Picture Title	Release Date	Shares
1 Pollyanna	January 18, 1920.....	111
2 Suds	June 27, 1920.....	111
3 Love Light	January 9, 1921.....	111
4 Through the Back Door	May 15, 1921.....	111
5 Little Lord Fauntleroy	November 13, 1921.....	111
6 Tess of the Storm	November 12, 1922.....	111
7 Rosita	October 28, 1923.....	111
8 Dorothy Vernon	August 3, 1924.....	111
9 Little Annie Rooney	October 18, 1925.....	112
Total shares delivered.....		1,000

DOUGLAS FAIRBANKS

1 His Majesty the American	September 1, 1919.....	111
2 When The Clouds Roll By	December 28, 1919.....	111
3 The Mollycoddle	June 13, 1920.....	111
4 The Mark of Zorro	December 5, 1920.....	111
5 The Nut	March 6, 1921.....	111
6 The Three Musketeers	October 2, 1921.....	111
7 Robin Hood	January 28, 1923.....	111
8 Thief of Bagdad	December 25, 1924.....	111
9 Don Q, Son of Zorro	August 30, 1925.....	112
Total shares delivered.....		1,000

(Testimony of Dennis Francis O'Brien.)

Picture Title	Release Date	Shares
D. W. GRIFFITH		
1 Broken Blossoms	October 20, 1919.....	111
2 The Love Flower	September 5, 1920.....	111
3 Dream Street	May 16, 1921.....	111
4 Way Down East	August 21, 1921.....	111
5 Orphans of the Storm	April 30, 1922.....	111
6 One Exciting Night	December 24, 1922.....	111
7 The White Rose	August 19, 1923.....	111
8 America	August 17, 1924.....	111
9 Isn't Life Wonderful	November 23, 1924.....	112

Total shares delivered.....1,000

CHARLES CHAPLIN

1 Woman of Paris	November 4, 1923.....	166
2 The Gold Rush	August 16, 1925.....	167
3 The Circus	January 7, 1928.....	166
4 City Lights	March 1, 1931.....	167

666

1935..... 334

1,000

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Q. (By Mr. Green) Were there any dividends declared upon the shares of common stock of United Artists Corporation between 1919 and 1935 when this last 334 shares of stock was released from escrow? A. Yes.

Q. And were those dividends in the amount of \$44,532.22, which were actually declared upon the 334 shares of stock that you released to Mr. Chaplin in September of 1935?

(Testimony of Dennis Francis O'Brien.)

A. I wouldn't know the amount personally, but that is what Price Waterhouse Company figures show that I saw yesterday.

The Court: Isn't that stipulated, Mr. Green?

[98]

Mr. Green: I believe so.

Mr. Horner: Yes, it is stipulated, your Honor. It is also admitted in the answer.

Q. (By Mr. Green) What was done with these dividends at the time they were declared by the United Artists Corporation in connection with the stock that was then held by you in escrow, Mr. O'Brien?

A. Pursuant to the bylaws they had to be voted out to the owners of the stock and the shareholders that appeared upon record as of the time when they were voted, and they were then, after they had been declared and became the property of the owner, they were then put into a special account called Trust Account No. 1 and upon which interest was paid on those particular moneys and then they became part of the original contract pursuant to the distribution contract as security for the performance of the contract.

Q. Then, when any shares of common stock were released by you from escrow, were the dividends which had been declared upon those particular shares of common stock and impounded or placed in escrow also released to the artists?

A. They were.

(Testimony of Dennis Francis O'Brien.)

Q. And at the time the dividends were actually delivered over to Mr. Chaplin the interest was also delivered and paid to him, was it not?

A. That is correct. [99]

Q. Now, Mr. O'Brien, I call your attention to Petitioner's Exhibit No. 7, which is the escrow agreement, dated August 5, 1919, under which 1,000 shares of stock issued to Mr. Chaplin was placed with you in escrow pursuant to his distribution agreement of February 5, 1919. I will ask you what were the reasons for placing these 1,000 shares of common stock in escrow with you.

Mr. Horner: If the Court please, that seems to be burdening the record unnecessarily. The contracts in evidence in this case show the reasons for these deposits with the escrow agent. I don't think he can add anything to it.

The Court: If he can add anything to it, we will hear him.

The Witness: It was in conformity with the basic agreement in the very last paragraph, as I recollect it, in which they agreed to do certain things with the corporation and for the benefit of each other, and so forth, and that in my opinion that part of that basic contract was never supplemented by any other act done by the parties thereto.

From the very beginning it was the desire—as took place in the discussions and as carried out by the attorneys representing the four participants—that they would own their own corporation. They

(Testimony of Dennis Francis O'Brien.)

would have no foreign interest represented in that corporation, and they were going to do as far as they were able, and as far as their attorneys could [100] advise, to put the addition of such a foreign interest—to make it practically impossible. They had one prohibition in there about the sale of the stock: it would have to be offered to each of the others before it could be sold. Of course, that didn't protect them completely, because the sale price might be way beyond what they would care to pay for it and that foreign interest might come in, just as we had had in another corporation we were in where Miss Pickford had half of the stock, yet that didn't prevent the other half from turning this over to Paramount. The other was that as evidence of their good faith and as their desire to have this whole thing on as near a spirit of equality without one profiting on the stock of the other, so that each one would be entitled to sharing in the number of pictures that was delivered by that person to the others, we all knew, and it was very apparent that these four producers would all start at different times. Mr. Chaplin had quite a burden ahead of him before he would complete his contract, and as it was, it wasn't completed within the three year period. Douglas was nearly ready, and he would start first. And D. W. Griffith came along then, and then Mary had either one or two pictures to finish with First National. Now, then, by putting that stock and the dividends and security

(Testimony of Dennis Francis O'Brien.)

for their particular promises to each other and to the corporation, it made it nearly [101] prohibitive for anybody getting into that corporation other than a producer and a producer of the type of motion pictures that would sell themselves and not be sold by other pictures. And this worked out pretty nearly in keeping with what it was originally planned, to make it cooperative. In other words, Douglas had seven pictures delivered. His stock and security and the dividends, if any, coming up. Now, then, Charlie would have to deliver an equivalent amount of pictures, or as subsequently worked out, pictures that grossed equal to the amount of Douglas before he really got the earnings.

It was an equal basis. There was never any thought but what that was the stock of the owners. Otherwise the corporation couldn't function. It would violate every provision of its bylaws and of its incorporation papers. They had the right to vote it and did vote it. They had the right to get the dividends, but they went up as security, and that was the reason for it, and all got their stock that way. It is my belief that when those dividends were declared they then belonged to the owners and the tax then should be paid on them.

Mr. Horner: If the Court please, I ask the last clause of the witness' statement be stricken as not responsive to the question.

The Court: We will let it stand, though it will not [102] be persuasive upon us. I don't think that it is responsive.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: Mr. Horner, I don't believe I covered it in the record, so may it be stipulated that United Artists Corporation was actually organized on April 17, 1919?

Mr. Horner: Yes. I will stipulate to that.

Mr. Green: Thank you.

Q. At the time of the expiration of the three year period called for in Petitioner's Exhibit No. 5 during which time Mr. Chaplin was required to produce and deliver to United Artists Corporation nine pictures, had he actually during that period of time delivered any pictures to United Artists Corporation?

A. That is the first three years?

Q. Yes. A. No.

Q. Now, I call your attention to Petitioner's Exhibit No. 7, which provides in paragraph fourth as follows: "At the expiration of said three years the depository shall deliver to the corporation so many of the certificates deposited hereunder as then remained in escrow and not the property of the artists, and the artists shall return to the depository the certificate of deposit which he then holds."

I will ask you if upon the expiration of said three year period you did pursuant to this agreement of August 5, 1919, actually deliver back to United Artists Corporation [103] any of the shares of common stock issued to Mr. Chaplin evidenced by Petitioner's Exhibit No. 4. A. I did not.

Q. Was any demand made upon you by United

(Testimony of Dennis Francis O'Brien.)

Artists Corporation to deliver back any of those shares of stock to the corporation? A. No.

Q. Was any demand made upon you by any other stockholder, officer, or director of United Artists Corporation to deliver back those shares of stock issued to Mr. Chaplin? A. No.

Q. During said three year period was there any agreement entered into for the filing of said agreement of February 5, 1919, which it has the effect of giving Mr. Chaplin an extension of time under which he would be required to deliver those nine pictures? A. No.

Q. Upon the expiration of the three year period from February 5, 1919, was any demand made that you deliver back to United Artists Corporation any shares of common stock which you held in escrow for any of the other parties to those distribution agreements?

A. No demand of any kind from anybody.

Q. And isn't it true that upon the expiration of said three year period each of the parties to those distribution [104] agreements was in default so far as the completion of nine pictures within the three year period of time is concerned?

A. I would say that they had not delivered them. I wouldn't say they were in default. I didn't give that consideration. I never asked.

Q. But, nevertheless, you did continue to hold these shares of stock for each one of them pursuant to the escrow agreement? A. Yes.

(Testimony of Dennis Francis O'Brien.)

May I explain that?

Mr. Horner: Yes.

The Court: I think we will suspend at this time for a brief recess.

(At this point a short recess was taken, after which proceedings were resumed, as follows:)

The Court: You may proceed. I think there was probably an unanswered question. The witness just started to answer. Will you read the last question and answer?

(The record referred to was read by the reporter, as set forth above.)

The Court: You started to explain it when I interrupted you.

The Witness: I have forgotten the explanation.

The Court: You may proceed. You may ask another question. [105]

The Witness: This is what I wanted to add there, that we all know Mr. Chaplin was having a great deal of litigation at the time over the delivery of "The Kid" to the First National, and we knew that he couldn't be making pictures, so we all knew the whole situation there and that he had departed from the production of two to three reel pictures to longer pictures, six reels or more that required a great deal of time. So it was quite apparent to everybody. We were all close together. That was the only explanation. You can strike it from the record, if you want, but that was probably why nothing was done at that time.

(Testimony of Dennis Francis O'Brien.)

Q. (By Mr. Green) As a matter of fact, the four pictures, "The Woman of Paris," "The Circus," "The Gold Rush," and "City Lights" were all pictures of five reels or greater, were they not?

A. They are; the sort of pictures not contemplated by the agreement when it was first drawn.

Q. I call your attention to the fact that Petitioner's Exhibit No. 5 calls for pictures, nine pictures, within the three year period of between 1600 and 3000 lineal feet in length.

A. That is right.

Q. And how many—

A. (Interrupting) Also a right to produce what was called an extraordinary picture, such as "The Birth of A Nation" or [106] "The Kid," when they could do that after they would have made the minimum required.

Q. Approximately how many feet are there in an ordinary picture?

A. At that time they were five reels. They ran from about 4600, 4500 feet, to 7,000 feet, 1,000 foot a reel. In other words, an hour was the part of the program that was used pretty much for the feature picture, and the second hour for the variety part, the short part, or whatever else might be there, like newsreels or special features of short duration to make up the program of two hours to a general program.

Q. Mr. O'Brien, what rights did Mr. Chaplin exercise in connection with this 1,000 shares of

(Testimony of Dennis Francis O'Brien.)

common stock during the period of time that it was held by you in escrow?

Mr. Horner: Just a moment. I don't believe I understand the nature of the question. What right? I don't know what kind of rights you are talking about.

Mr. Green: I mean by voting, voting rights, attending directors' meetings, stockholders' meetings, participating to the fullest extent in every way in the management and direction of the affairs of United Artists Corporation.

Q. You may answer.

A. He had the right to vote and the right to receive notices, and the right to have dividends voted on the [107] stock and subsequently put into a form of escrow, or it wasn't deposited, because the corporation kept that money in a special fund; and he exercised all of the rights set forth in the bylaws as the holder or owner of the stock. And in my judgment it was specifically set forth, and I might be termed the holder of that stock, that I had no right to vote.

Q. The escrow agreement, which is Petitioner's Exhibit No. 7, expressly provides that Mr. Chaplin shall have the right to vote the stock during the time it was in escrow, does it not?

A. That is right.

Q. And during the period of time that any or all of these shares of common stock was in escrow did Mr. Chaplin at all times vote the full 1,000 shares?

A. That is my recollection.

(Testimony of Dennis Francis O'Brien.)

Q. Did he attend stockholders' meetings from time to time?

A. When we held them out here, and in the east Nathan Burkan, his attorney, who has since left us, I am sorry to say, voted that. He was his proxy. He had that right to issue proxies.

Q. Did Mr. Chaplin attend directors' meetings from time to time? A. Oh, yes.

Q. Did he participate fully in the direction of the affairs of the corporation at all times? [108]

A. He certainly did, and was very valuable.

Q. Mr. O'Brien, was there any distinction at any time in the voice that each stockholder was entitled to enjoy dependent upon the question of whether or not his stock was in or out of escrow?

A. Their stock was treated exactly as Mr. McAdoo's stock.

Q. So that every stockholder had equal voting rights and equal rights in every respect in connection with their shares of common stock regardless of whether it was in or out of escrow?

A. That is right.

Q. That is right? A. That is correct.

Q. Mr. O'Brien, I will ask you if immediately after the corporation was organized if you became a director. A. Yes.

Q. And what office or offices have you held for the corporation during the time it has been in existence?

A. With the exception of a very short period I

(Testimony of Dennis Francis O'Brien.)

have been a director, and part of the time I have been secretary, and most of the time first vice president, and for a period of years when we hadn't any president, that is, after Mr. McAdoo's resignation and Mr. Oscar Price, whom he designated as president, because he had the right under the agreement to designate the president and the secretary, I acted as [109] the president. There is little to do, because the general sales manager, Mr. Abrams, did the selling.

Q. I will ask you if you have acted at any time as general counsel for the corporation.

A. Oh, yes, even when Mr. McAdoo was—his firm were acting, because I did practically all of the work, because they weren't familiar with it.

Q. And when did Mr. McAdoo cease to be connected with the corporation?

A. At the second annual meeting in April of the year succeeding.

Q. That would be April of 1920?

A. April of 1920 or thereabouts.

Q. Yes.

Now, I will show you an affidavit of Dennis F. O'Brien, dated July 25, 1930, and ask you if you are the person who executed that affidavit.

A. (Examining document.) I am.

Q. I will ask you if you will describe the purposes for which this affidavit was given by you.

A. It was provided to clear up the question of ownership of stock in England on a tax question

(Testimony of Dennis Francis O'Brien.)

and given at the request of Price Waterhouse and Company, the English subdivision and a Mr. Godela, counsel for the United Artists, and it recites the history of the issuance of our stock here and [110] the ownership of the stock, and upon that affidavit—well, this is the information, of course, Mr. Godela informed me the question was cleared and the proper entry made.

Q. This affidavit recites at that time that you were both a director and attorney for the corporation, does it not? A. That is correct.

Q. And that you made this affidavit for and on behalf of the corporation?

A. And it was approved by the board of directors, and a certificate to that effect sent over with the affidavit.

Q. Now, I call your attention to the fact that paragraph ninth of the agreement provides:—

Mr. Horner: Just a moment, please. Mr. Green, did you intend to offer this affidavit in evidence?

Mr. Green: Yes.

Mr. Horner: I suggest you do it at this time, so I can object to it, and if the Board permits it to be placed in evidence, then there will be a little greater leeway on my part so far as your examination will be concerned. I don't want to direct your movements, but it seems to me it is improper to quote from the affidavit when it isn't even in evidence or hasn't been marked.

Mr. Green: At this time, if the Court please,

(Testimony of Dennis Francis O'Brien.)

I would like to offer a conformed copy of this affidavit in evidence as Petitioner's Exhibit No. 16, I believe.

The Court: It may be handed to the Clerk and marked for identification as Petitioner's Exhibit No. 16.

(The said document, so offered, was marked Petitioner's Exhibit No. 16 for identification.)

Mr. Horner: You are offering that in evidence, Mr. Green, at this time?

Mr. Green: Yes.

Mr. Horner: I object, your Honor. I haven't seen the affidavit, but from what little I have heard, I assume it is an attempt on the part of this witness to explain the ownership of the stock, something that your Honor ruled on this morning, and furthermore, it seems to me to be wholly immaterial in this proceeding. It is apparently related to some controversy with England over some taxes; a self-serving declaration, probably.

Mr. Green: It couldn't be a self-serving declaration, because Mr. O'Brien is not a party to this proceeding.

Mr. Horner: He is an officer of the corporation.

The Court: Let's let counsel examine the document. He may not wish to object to it.

Mr. Horner: May I offer one more objection, your Honor, and that is that the witness who executed this particular affidavit is present, and it

(Testimony of Dennis Francis O'Brien.)

seems to me that anything that it is proper for him to say in the form of [112] an affidavit certainly ought to be proper for him to say in the form of testimony.

Q. (By Mr. Green) Calling your attention to paragraph——

The Court (Interrupting): Just a moment. I doubt if the document is admissible in evidence for any purpose. The witness who made the affidavit is here. If you wish him to testify to any facts, he, of course, can do so.

Mr. Green: If your Honor please, the Petitioner's contention is that the affidavit is admissible in evidence, at least so much of the affidavit as relates to this particular proceeding is admissible in evidence, for this reason: The affidavit was made by Mr. O'Brien in 1930 at a time when he was the general counsel for the corporation, when he was also a director of the corporation. He makes the affidavit for and on behalf of the corporation, and the particular points in the affidavit that are vital to the issues in this case are that in the affidavit he recites who the stockholders are of the corporation and the number of shares that each own. Now, it is our contention that the affidavit is admissible, because here is an affidavit by the corporation in 1930 reciting who the stockholders were and how many shares they own, and the affidavit in this particular instance shows that Mr. Chaplin was the owner of 1,000 shares of common stock; and for that reason,

(Testimony of Dennis Francis O'Brien.)

if your Honor please, I submit that the affidavit is proper evidence in this [113] proceeding.

The Court: No. I think not. If he had made, or the corporation had made some contrary statements, it might be permissible to show in evidence the admission to the contrary, but I know of no reason why an affidavit made *ex parte* should be received, especially when we have the witness who made the very affidavit himself at the hearing. I don't know what you can prove by that affidavit that you can't prove by the man who made the affidavit, and he is here.

Mr. Green: As I understand it, if your Honor please, this affidavit, since it was made on behalf of the corporation, and as its act, is just as material and just as much a corporation document as the stock certificates, as the contract, as any other instrument executed on behalf of the corporation to show the condition of its affairs and who its stockholders were. I can't see any distinction.

The Court: Well, you don't have any corporate records here, as I understand it, which this affidavit is embodied as a part of the records of the corporation.

Mr. Green: Yes, your Honor.

The Court: Where are they?

Mr. Green: The minute book. This came out of the minute book.

The Court: If you desire to introduce a minute book [114] of the corporation in evidence for some purpose, it may be admissible.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: If your Honor please, aren't we permitted, and I would like to offer this affidavit in evidence as being an extract from or a portion of the minute book itself. I don't care to offer the entire minute book, but I would like to offer this as a part of the minute book.

Mr. Horner: If the Court please, this, as I explained before, is new to me in the case. I have had no opportunity to read it or consider it, and I don't wish to be unduly obstreperous in my objections, but I can't see any basis at the present time for agreeing to this procedure. And if Mr. Green will pass that for the time and at least until after recess and give me an opportunity, maybe I will help him. I will if I can.

The Court: On the showing made so far, I will have to sustain the objection to the receipt in evidence of the document, which has been marked for identification as Petitioner's Exhibit No. 16.

Mr. Green: May we have an exception, your Honor?

The Court: Exception may be noted.

Mr. Wright: It is understood that we may pursue the matter with Mr. Horner after recess?

The Court: Yes.

Q. (By Mr. Green) Mr. O'Brien, Mr. Chaplin was never under [115] contract at any time to render any personal services to United Artists Corporation, was he? A. He was not.

Q. And did he during the period from the in-

(Testimony of Dennis Francis O'Brien.)

ception of the corporation to September of 1935, when the remaining two certificates were released from escrow, render any services to the United Artists Corporation except such services as a director, officer, and a stockholder usually renders to a corporation? A. He did not.

Mr. Green: Mr. Horner, I propose to offer in evidence a series of excerpts from the minutes of directors, stockholders and executive committee meetings of the United Artists Corporation at this time. I believe I furnished you with copies of these minutes, and in the interest of time, if you would like to follow me with your copy as I go through, you may.

Mr. Horner: Just a moment. Off the record a moment.

The Court: Very well.

(Discussion outside the record.)

The Court: On the record.

Q. (By Mr. Green) Mr. O'Brien, I show you an excerpt from the resolution of the board of directors' meeting of United Artists of April 24, 1919, relating to compensation to be paid to the firm of McAdoo, Cotton and Franklin for their [116] services as counsel for the corporation. That is a true excerpt from the minutes of the corporation meeting?

A. Yes. That is substantially as I just testified about it.

Mr. Green: I would like to offer as Petitioner's Exhibit next in order this document.

(Testimony of Dennis Francis O'Brien.)

The Clerk: 17.

Mr. Horner: No objection.

The Court: Very well. It will be received as Petitioner's Exhibit No. 17.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 17, and made a part of this record.)

PETITIONER'S EXHIBIT No. 17

(copy of resolution from "Minutes of the First Meeting of the Board of Directors of United Artists Corporation held April 24, 1919)

"Upon motion duly made, seconded, and carried, it was

Resolved that McAdoo, Cotton & Franklin, Esqrs., be retained as General Counsel for the corporation and that they be paid a retaining fee for their services as General Counsel for the calendar year of 1919 of Fifty Thousand dollars (\$50,000), such compensation to cover services rendered by them in connection with the preparation of contracts and preliminary organization of the corporation and shall include the giving of personal attention to the matters of the corporation and the handling of the usual office work and the attendance at conferences at their office in New York City, but

(Testimony of Dennis Francis O'Brien.)

not services in special matters or in litigation, compensation for which services if rendered to be additional and specially provided for."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Q. (By Mr. Green) Now, I will show you an excerpt from the minutes of special meeting of the board of directors of United Artists Corporation on May 29, 1919, relating to the issuance of 5,000 shares of the common stock of the United Artists Corporation. A. That is correct.

Q. And these minutes provide for the issuance of 5,000 shares of common stock, do they not?

A. Yes, sir, and also for designating Dennis F. O'Brien as escrow agent.

Q. Now, the 5,000 shares of stock were issued pursuant to those minutes, were they not? [117]

A. That is correct.

Q. And 1,000 shares of that stock were the ones that were issued to Mr. Chaplin, Petitioner's Exhibit 4? A. Yes. Yes.

Q. And this also provides for the issuance of 1,000 shares of stock to Mr. McAdoo?

A. That is correct.

Q. And what is the consideration for the execution of Mr. McAdoo's stock, for the issuance of Mr. McAdoo's stock?

A. To resolve that in consideration of the delivery of said contracts to this corporation—

(Testimony of Dennis Francis O'Brien.)

The Court (Interrupting): Don't read the exhibit. If you are going to offer it, let's offer it.

The Witness: It is recited in there.

The Court: Is it an exhibit?

Mr. Green: Yes.

The Court: No. 18. Any objection?

Mr. Horner: No objection.

The Court: It will be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 18, and made a part of this record.)

PETITIONER'S EXHIBIT No. 18

(excerpt from "Minutes of Special Meeting of the Board of Directors of United Artists Corporation Held on May 29, 1919" at 729 Seventh Avenue, New York.)

"The secretary presented four (4) certain contracts each dated February 5, 1919, executed respectively by Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) such four contracts being known collectively as the artists' contracts and executed by this corporation on the 29th day of May, 1919, pursuant to resolution of the Board of Directors adopted at a meeting of said Board, held on May 20th, 1919, said contracts being delivered on behalf of the above-named artists

(Testimony of Dennis Francis O'Brien.)

to this corporation in accordance with a certain contract between the above-named artists also dated February 5th, 1919, providing for the incorporation of this corporation, copy of which last mentioned contract was also presented by the secretary and directed to be filed among the corporate records of this corporation. Whereupon the following resolutions made by Mr. Banzhaf and seconded by Mr. Burkan were unanimously adopted:

Whereas in the judgment of the Board of Directors the photoplays agreed to be delivered to this Corporation under said contracts are necessary for the business of this Corporation and constitute good and sufficient consideration for the issue of five thousand (5000) shares of the common stock of this corporation, the same being without par or nominal value:

Resolved that, in consideration of the delivery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are, authorized to issue and deliver to William G. McAdoo, Esq., one thousand (1,000) shares of no par value of this corporation fully paid and non-assessable, said shares to include the shares of no par value subscribed for by the signers of the certificate of incorporation of this Corporation, assignments of said subscriptions being held by him; and

Resolved that, in consideration of the deliv-

(Testimony of Dennis Francis O'Brien.)

ery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are, authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) one thousand (1,000) shares of no par value each, making a total of four thousand (4,000) shares of no par value to a person or corporation to be agreed upon by said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation, and to no other person, said four thousand (4,000) shares to be held by said person or corporation in escrow in accordance with the provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation; and

Resolved that the proper officers of this Corporation be, and they hereby are, authorized and directed to execute an escrow agreement for the holding and delivery of said four thousand (4,000) shares of non-par value in accordance with the terms and provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation dated Febru-

(Testimony of Dennis Francis O'Brien.)

ary 5th, 1919, said escrow agreement to provide that while said four thousand (4,000) shares are held in escrow, each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this corporation before execution of the same by its officers.

On motion of Mr. Burkan, seconded by Mr. Banzhaf, Mr. Dennis F. O'Brien was designated as escrow agent for the corporation to hold the four thousand (4,000) shares of no par value common stock to be issued to the four artists. At the same time the treasurer was authorized to reimburse Mr. O'Brien for such expense as he may incur in renting a safe-deposit box for the safe-keeping of such shares of stock."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

The Court: You may call our attention to it in brief, but this is not necessary to read it into the record.

Mr. Green: I would like to offer this as Petitioner's [118] Exhibit 18.

Q. I will show you the minutes of the regular meeting of the board of directors of the United Artists Corporation, June 10, 1919, relating to an amendment of the distribution agreement of Mr.

(Testimony of Dennis Francis O'Brien.)

Chaplin's dated February 5, 1919. I would like to offer these in evidence as Petitioner's Exhibit next in order. A. That is correct.

The Court: Any objection?

Mr. Horner: No objection.

The Court: It will be received as Petitioner's Exhibit No. 19.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 19, and made a part of this record.)

PETITIONER'S EXHIBIT No. 19

Minutes of Regular Meeting of Board of Directors
of United Artists Corporation Held
June 10, 1919

A regular meeting of the Board of Directors of the United Artists Corporation was held in the offices of the Corporation at 729 Seventh Avenue in the city of New York, N. Y., on the 10th day of June, 1919, at 3:20 o'clock p.m.

Present: Mrs. Pickford, Messrs. Banzhaf, Burkan, O'Brien and Price.

The minutes of the special meeting of May 29th were read, and on motion duly made and seconded, were unanimously approved.

On motion duly made, seconded and unanimously carried, it was

Resolved, that the President be and he here-

(Testimony of Dennis Francis O'Brien.)

by is authorized to enter into an agreement on behalf of this Corporation with the several Artists amending Subdivision (i) of Paragraph 3 of each of the contracts between United Artists Corporation and the several Artists dated February 5, 1919, so that said subdivision in each of said contracts shall read substantially as follows:

“And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation to be issued in the name of the said Artists in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each, and one of which shall be for one hundred and twelve (112) shares, said certificates to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto. Upon delivery by the said Artist to the said Corporation of each one of the first eight (8) photoplays called for by this contract, such escrow agent shall deliver to the said Artist one of said certificates for one hundred and eleven (111) shares and upon delivery by the said Artist to the said Corporation of the ninth photoplay called for hereunder such escrow agent shall deliver to the said Artists said certificate for one hundred and twelve (112) shares. Upon the expiration of the three-year period herein provided for, so many of said certificates as are then still held by

(Testimony of Dennis Francis O'Brien.)

such escrow agent in accordance with the provisions of this paragraph shall be delivered by such escrow agent to the said corporation."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: Mr. Horner, in the interest of time, will you be willing to stipulate that these are excerpts from the minutes of the corporation on the dates on which they bear and may we introduce them in evidence as respective exhibits in order without identifying them?

Mr. Horner: Yes, Mr. Green. That is perfectly agreeable to me. I assume what you have in mind offering are exact copies of the ones that you have given me, and there are no additional ones?

Mr. Green: I have some additional ones here which I [119] will be glad to show you.

Mr. Horner: If you will do that, that will be all right. I have no objection.

Mr. Wright: May the stipulation, Mr. Horner, go further, that Mr. O'Brien would identify them as such?

Mr. Horner: Yes.

The Court: Very well. They may be identified briefly for the record and received, giving them the consecutive exhibit numbers.

The next one will be Exhibit 20.

Mr. Green: Exhibit 19 is a two-page document.

(Testimony of Dennis Francis O'Brien.)

The Clerk: The date is June 10, 1919. That is Exhibit No. 19.

Mr. Green: The next one would be an alphabetical list of the stockholders of the United Artists Corporation, March 1925.

The Court: That will be exhibit No. 20, and it may be received.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 20, and made a part of this record.)

PETITIONER'S EXHIBIT No. 20
UNITED ARTISTS CORPORATION
organized under the laws of Delaware
Alphabetical List of Stockholders
At closing of books on March 1925.

Name		Shares	
		Common	Preferred
Mary Pickford Fairbanks	Los Angeles, Cal.....	1000	300
Douglas Fairbanks	Los Angeles, Cal.....	1000	300
Charles Chaplin	Los Angeles, Cal.....	1000	300
D. W. Griffith, Inc.	Los Angeles, Cal.....	1000	300
Joseph M. Schenck	Los Angeles, Cal.....	1000	—
		5000	1500

Correct:

ALBERT H. T. BANZHAF.
Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Horner: That should be 21, I think, your Honor. We just put a proxy in as No. 20, at least I thought you did.

Exhibit 19 is this document?

The Clerk: Yes. [120]

Mr. Horner: June 10, 1919.

No 20 is this list of stockholders of March, 1925?

Mr. Green: That is right.

Now, No. 21 will be a proxy executed by Charles Chaplin dated June 26, 1919.

The Court: It will be received as Petitioner's Exhibit No. 21.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 21, and made a part of this record.)

—————

PETITIONER'S EXHIBIT No. 21

United Artists Corporation Proxy

Know All Men By These Presents:

That I, Charles Chaplin, do hereby constitute and appoint Nathan Burkan to be my lawful attorney and substituted proxy for me and in my name, to vote upon all the stock held by me in United Artists Corporation, at a special meeting of shareholders of such corporation to be held on the 26th day of June, 1919, and at any adjourned meeting thereof, as fully and with the same effect as I

(Testimony of Dennis Francis O'Brien.)
might or could do were I personally present at such meeting.

In Witness Whereof, I have hereunto set my hand and seal this 26th day of June, 1919.

CHARLES CHAPLIN

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next will be an adjourned stockholders' meeting, special meeting, of United Artists Corporation, dated "Held September 9, 1919," which is a three-page document.

The Court: It will be Exhibit No. 22.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 22, and made a part of this record.)

PETITIONER'S EXHIBIT No. 22

UNITED ARTISTS CORPORATION

Adjourned Stockholders' Special Meeting

Minutes of adjourned special meeting of United Artists Corporation, duly called and held at the office of the Corporation, No. 729 Seventh Avenue, New York City, on Sept. 9th, 1919, at four o'clock p.m., pursuant to adjournment duly taken at 3:05 o'clock p.m., on July 21st, 1919.

The Secretary reported that there were repre-

(Testimony of Dennis Francis O'Brien.)

sented by Dennis F. O'Brien, Nathan Burkan and Albert H. T. Banzhaf, as proxies, 4000 shares out of the entire issue of 5000 common shares outstanding and that the common stock of the Corporation is the only class of stock outstanding entitled to vote.

There being a quorum present, the Secretary read to the meeting the minutes of the special meeting of stockholders held June 26th, and of an adjourned meeting thereof held July 21st, of which said meetings this meeting is an adjournment, and said minutes were unanimously approved.

The Secretary presented and read the following resolutions which were adopted by the Board of Directors of the Corporation at a special meeting thereof held at No. 729 Seventh Avenue, New York City, on May 29, 1919:

“Whereas, in the judgment of the Board of Directors the photoplays agreed to be delivered to this Corporation under said contracts are necessary for the business of this corporation and constitute good and sufficient consideration for the issue of five thousand (5,000) shares of the common stock of this Corporation, the same being without par or nominal value:

“Resolved that, in consideration of the delivery of said contracts to this corporation, the proper officers of this Corporation be, and they hereby are, authorized to issue and deliver to William G. McAdoo, Esq., one thousand (1,000)

(Testimony of Dennis Francis O'Brien.)

shares of no par value of this Corporation fully paid and non-assessable, said shares to include the shares of no par value subscribed for by the signers of the certificate of incorporation of this Corporation, assignments of said subscriptions being held by him; and

“Resolved that, in consideration of the delivery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) one thousand (1,000) shares of no par value each, making a total of four thousand (4,000) shares of no par value to a person or corporation to be agreed upon by said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this corporation, and to no other person, said four thousand (4,000) shares to be held by said person or corporation in escrow in accordance with the provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation; and

“Resolved that the proper officers of this Corporation be, and they hereby are, authorized and directed to execute an escrow agree-

(Testimony of Dennis Francis O'Brien.)

ment for the holding and delivery of said four thousand (4,000) shares of non-par value in accordance with the terms and provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation dated February 5th, 1919, said escrow agreement to provide that while said four thousand (4,000) shares are held in escrow, each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this Corporation before execution of the same by its officers."

Upon motion duly made, seconded and unanimously carried, it was

Resolved, that the shareholders of this corporation do hereby in all respects ratify, adopt and confirm the aforesaid resolutions of the Board of Directors and the action taken or to be taken thereunder by said Board, and do hereby consent to the issuance of the common stock of this corporation in the manner provided for in said resolutions.

(Signed) G. B. CLIFTON
 Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: Next is an alphabetical list of stockholders of the United Artists Corporation as of the close of the books on March 16, 1920.

The Court: That will be received as Petitioner's Exhibit 23.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 23, and made a part of this record.) [121]

PETITIONER'S EXHIBIT No. 23
UNITED ARTISTS CORPORATION
COMPANY
Organized
Under the Laws of
Delaware

Alphabetical List of Stockholders,
At Closing of Books on the 16th day of March, 1920.

Name	Residence	Shares	
		Common	Preferred
Charles Chaplin	Los Angeles, Calif.....	1000	300
Douglas Fairbanks	Los Angeles, Calif.....	1000	300
David W. Griffith	720 Longacre Building.....	1000	300
	New York N Y		
Gladys Mary Moore	Los Angeles, California.....	1000	300
William G. McAdoo	120 Broadway	1000	
	New York N Y		
		<hr/> 5000	<hr/> 1200

Correct

G. B. CLIFTON
Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: Next is a proxy executed by Charles Chaplin on the 18th day of March, 1920, the proxy being in favor of Nathan Burkan, B-u-r-k-a-n.

The Court: That will be received as Petitioner's Exhibit No. 24.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 24, and made a part of this record.)

PETITIONER'S EXHIBIT No. 24

Proxy

Know All Men By These Presents, that I the undersigned do hereby constitute and appoint Nathan Burkan my attorney and agent for me and in my name, place and stead to vote as my proxy at the annual meeting of the stockholders of United Artists Corporation to be held at No. 7 West 10th Street, Wilmington, Delaware, on the 5th day of April, 1920, at 3 o'clock in the afternoon, or any adjournment thereof, for the election of directors and officers, and to act upon any matter that may come before the said annual meeting, or any adjournment thereof, according to the number of votes I should be entitled to vote if then personally present at the said meeting.

(Testimony of Dennis Francis O'Brien.)

In Witness Whereof I have hereunto set my hand and seal this 18 day of March, 1920.

[Seal]

CHARLES CHAPLIN

Witness:

ALFRED REEVES

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is a ballot of stockholders, election of directors and officers, Nathan Burkan, 5,000 shares, proxy for Charles Chaplin.

The Court: It will be received as Petitioner's Exhibit No. 25.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 25, and made a part of this record.)

PETITIONER'S EXHIBIT No. 25

Ballot of Stockholders

Election of Directors and Officers

For Directors of United Artists Corporation

- | | | | |
|----|---------------|-------|--------|
| 1. | Nathan Burkan | 5000 | shares |
| 2. | | | shares |
| 3. | | | shares |
| 4. | | | shares |
| 5. | | | shares |

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of stockholders of the United Artists Corporation on March 26, 1921.

The Court: It will be received as Petitioner's Exhibit No. 26.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 26, and made a part of this record.)

PETITIONER'S EXHIBIT No. 26

UNITED ARTISTS CORPORATION

organized under the Laws of Delaware

Alphabetical List of Stockholders

At closing of books on the 26th day of March, 1921

Name	Residence	Shares	
		Common	Preferred
Charles Chaplin	Los Angeles, Calif.....	1000	300
Douglas Fairbanks	Los Angeles, Calif.....	1000	300
Gladys Mary Fairbanks	Los Angeles, Calif.....	1000	300
D. W. Griffith, Inc.	New York City, N. Y.	1000	300
United Artists Corporation	New York City, N. Y.	1000	—
		<hr/> 5000	<hr/> 1200

Correct:

ALBERT H. T. BANZHAF

Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: Next is a waiver of notice of meeting dated New York April 3, 1922. [122]

The Court: It will be received as Petitioner's Exhibit 27.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 27, and made a part of this record.)

PETITIONER'S EXHIBIT No. 27

Waiver of Notice of Meeting

We, the undersigned, being all of the stockholders of United Artists Corporation, do hereby consent that the time and place of holding the Annual Meeting of the said Corporation be changed from Monday, April 3rd, 1922, at 729 Seventh Avenue, Borough of Manhattan, City of New York, to April 10th, 1922, at the office of the Douglas Fairbanks Pictures Corporation, Hollywood, California, and we do hereby waive all notice whatsoever of the said Annual Meeting, and do hereby consent that the aforesaid time and place be and the same hereby is fixed as the time and place for holding the Annual Meeting of the Corporation, pursuant to the By-Laws, and that all such busi-

(Testimony of Dennis Francis O'Brien.)
ness may be transacted thereat as may lawfully
come before the said meeting.

Dated, New York, April 3rd, 1922.

MARY PICKFORD FAIRBANKS

DOUGLAS FAIRBANKS

CHARLES CHAPLIN

D. W. GRIFFITH, INC.

By ALBERT H. T. BANZHAF,
Sec.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is a proxy executed by
Charles Chaplin in favor of Nathan Burkan dated
March 21, 1923.

The Court: It will be received as Petitioner's
Exhibit No. 28.

(The said document, so offered and received
in evidence, was marked Petitioner's Exhibit
28, and made a part of this record.)

PETITIONER'S EXHIBIT No. 28

Know All Men By These Presents:

That I, Charles Chaplin do hereby constitute
and appoint Nathan Burkan to be my lawful attorney,
substitute and proxy for me and in my name,
to vote upon all the stock held by me in United

(Testimony of Dennis Francis O'Brien.)

Artists Corporation at the Annual Meeting of Stockholders of such corporation to be held on the 2nd day of April, 1923, and at any adjourned meeting thereof, as fully and with the same effect as I might or could do were I personally present at such meeting, and I hereby revoke any proxy or proxies heretofore given by me to any person or persons whatsoever.

In Witness Whereof I have hereunto set my hand and seal this 21st day of March, 1923.

CHARLES CHAPLIN

In the presence of:

MAURICE G. CLEARY

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is a waiver of notice of meeting dated April 17, 1924, executed by Charles Chaplin by Nathan Burkan and others.

The Court: It will be received as Petitioner's Exhibit 29.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 29, and made a part of this record.)

PETITIONER'S EXHIBIT No. 29

Waiver of Notice of Meeting.

We, the undersigned, being all of the stockholders of the United Artists Corporation, do hereby consent that the time and place of holding the An-

(Testimony of Dennis Francis O'Brien.)

nual Meeting of the said corporation, be fixed as Monday, April 7th, 1924, at 729 Seventh Avenue, Borough of Manhattan, New York City, at the office of the United Artists Corporation, and we do hereby waive all notice whatsoever of the said Annual Meeting, and do hereby consent that the aforesaid time and place be and the same hereby is fixed as the time and place for holding the Annual Meeting of the Corporation, pursuant to the By-laws, and that all such business may be transacted thereat as may lawfully come before said meeting.

Dated, April 7, 1924.

MARY PICKFORD FAIRBANKS

By DENNIS F. O'BRIEN

DOUGLAS FAIRBANKS

By DENNIS F. O'BRIEN

D. W. GRIFFITH, INC.

By ALBERT H. T. BANZHAF

CHARLES CHAPLIN

By NATHAN BURKAN

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an alphabetical list of stockholders of the United Artists Corporation at the close of books on March 28, 1924.

The Court: It will be received as Petitioner's Exhibit No. 30. [123]

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 30, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 30

UNITED ARTISTS CORPORATION
organized under the laws of DelawareAlphabetical List of Stockholders
At closing of books on March 28, 1924.

Name	Residence	Shares	
		Common	Preferred
Charles Chaplin	Los Angeles, Calif.....	1000	300
Douglas Fairbanks	Los Angeles, Calif.....	1000	300
Gladys Mary Fairbanks	Los Angeles, Calif.....	1000	300
D. W. Griffith, Inc.	New York City, N. Y.	1000	300
United Artists Corporation	New York City, N. Y.	1000	—
		<hr/> 5000	<hr/> 1200

Correct:

ALBERT H. T. BANZHAF.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from minutes of special meeting of the board of directors of United Artists Corporation held at 729 7th Avenue, New York, dated September 5, 1924.

The Court: It will be received as Petitioner's Exhibit No. 31.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 31, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 31

(excerpt from "Minutes of a Special Meeting of Board of Directors of United Artists Corporation", held at 729 Seventh Avenue, New York, December 5, 1924.)

"Mr. O'Brien presented to the meeting an original copy of a certain agreement, dated November 22nd, 1924, by and between Mary Pickford Fairbanks, Charles Chaplin, Douglas Fairbanks, Joseph M. Schenck and United Artists Corporation. Copies of this contract had been in the possession of each of the members of the Board of Directors for several days, and it was announced to the meeting that each of the Directors was thoroughly familiar with such contract."

"A motion was made, seconded and unanimously adopted by a vote of the Directors (save and except Mr. Banzhaf, who did not vote because he stated he had not had an opportunity to submit it to Mr. Griffith) that the act of Dennis F. O'Brien, as Vice-President, in executing said contract, was approved, and that his act became the act of the corporation, and that the corporation accepted the aforesaid contract and that it should become part of the minutes of this meeting."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of the stockholders of United Artists Corporation at the closing of books on March 28, 1927.

The Court: It will be received as Petitioner's Exhibit No. 32.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 32, and made a part of this record.)

PETITIONER'S EXHIBIT No. 32

UNITED ARTISTS CORPORATION

Organized under the Laws of the State of Delaware

Alphabetical List of Stockholders

At closing of Books on March 28th, 1927.

Names	Residences	Shares	
		Common	Preferred
Charles Chaplin	Los Angeles, Calif.....	1000	300
Douglas Fairbanks	Los Angeles, Calif.....	1000	300
Mary Pickford Fairbanks	Los Angeles, Calif.....	1000	300
D. W. Griffith, Inc.	New York City, N. Y.	1000	300
Joseph M. Schenck	Los Angeles, Cal.....	1000	300
United Artists Corporation	New York City, N. Y.	1000	—

Correct:

ALBERT H. T. BANZHAF,
Secretary.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of the stockholders of United Artists Corporation at the closing of books on March 28, 1926.

The Court: It will be received as Petitioner's Exhibit No. 33. [124]

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 33, and made a part of this record.)

PETITIONER'S EXHIBIT No. 33

UNITED ARTISTS CORPORATION

organized under the laws of Delaware

Alphabetical List of Stockholders.

At closing of books on March 28th, 1926.

Names	Residence	Shares	
		Common	Preferred
Charles Chaplin	Los Angeles, Calif.....	1000	300
Douglas Fairbanks	Los Angeles, Calif.....	1000	300
Gladys Mary Fairbanks	Los Angeles, Calif.....	1000	300
D. W. Griffith, Inc.	New York City, N. Y.	1000	300
Joseph M. Schenck	Los Angeles, Calif.....		
United Artists Corporation	New York City, N. Y.	1000	—

Correct:

ALBERT H. T. BANZHAF
Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of the stockholders of United Artists Corporation at the closing of books on March 28, 1928.

The Court: It will be received as Petitioner's Exhibit No. 34.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 34, and made a part of this record.)

PETITIONER'S EXHIBIT No. 34

UNITED ARTISTS CORPORATION

Organized under the Laws of the State of Delaware

Alphabetical List of Stockholders.

At closing of Books on March 28th, 1928.

Names	Residences	Shares	
		Common	Preferred
Charles Chaplin	Los Angeles, Calif.....	1000	
Douglas Fairbanks	Los Angeles, Calif.....	1000	
Mary Pickford Fairbanks	Los Angeles, Calif.....	1000	
Gloria Swanson	Los Angeles, Calif.....	1000	
Joseph M. Schenck	Los Angeles, Calif.....	1000	
D. W. Griffith, Inc.	New York City, N. Y.	1000	
Sam Goldwyn	New York City, N. Y.	1000	
United Artists Corporation	New York City, N. Y.	1000	
Art Cinema Corporation	New York City, N. Y.	1000	

Correct:

ALBERT H. T. BANZHAF
Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an excerpt from an adjourned annual meeting of the stockholders of United Artists Corporation, dated July 12, 1928.

The Court: It will be received as Petitioner's Exhibit No. 35.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 35, and made a part of this record.)

PETITIONER'S EXHIBIT No. 35

(Excerpt from "Adjourned Annual Meeting of the Stockholders of the United Artists Corporation", July 12, 1928)

"There were present in person or by proxy the following stockholders representing the number of shares set opposite their respective names:

Name	Name of Proxy	No. of Shares
Douglas Fairbanks	Dennis F. O'Brien.....	1000 Shares
Mary Pickford Fairbanks (also known as Gladys Mary Fairbanks)		
Gloria Swanson	Clinton J. Scollard.....	1000 Shares
Joseph M. Schenck	Dennis F. O'Brien.....	1000 Shares
D. W. Griffith, Inc.	Albert H. T. Banzhaf.....	1000 Shares
Samuel Goldwyn	Guy P. Morgan.....	1000 Shares
Art Cinema Corporation	Bertram S. Nayfack.....	1000 Shares
Charles Chaplin	Charles Schwartz	1000 Shares

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of the stockholders of United Artists Corporation dated March 28, 1930.

The Court: It will be received as Petitioner's Exhibit No. 36. [125]

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 36, and made a part of this record.)

PETITIONER'S EXHIBIT No. 36

UNITED ARTISTS CORPORATION

Organized under the Laws of the State of Delaware

Alphabetical List of Stockholders
At closing of Books, March 28, 1930

Names	Residences	Shares Common Stock
Art Cinema Corporation	729 Seventh Avenue New York City.....	1000
Charles Chaplin	Los Angeles, Cal.....	1000
Douglas Fairbanks	Los Angeles, Cal.....	1000
Mary Pickford Fairbanks	Los Angeles, Cal.....	1000
Samuel Goldwyn	Los Angeles, Cal.....	1000
D. W. Griffith	Los Angeles, Cal.....	500
D. W. Griffith, Inc.	New York City.....	500
Joseph M. Schenck	Los Angeles, Cal.....	1000
Gloria Swanson	Los Angeles, Cal.....	1000
United Artists Corporation	New York City.....	1000

Correct:

ALBERT H. T. BANZHAF

Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an excerpt from minutes of an adjourned annual stockholders' meeting of United Artists Corporation, May 7, 1929.

The Court: It will be received as Petitioner's Exhibit 37.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 37, and made a part of this record.)

PETITIONER'S EXHIBIT No. 37

(Excerpt from "Minutes of Adjourned Annual Stockholders Meeting of the United Artists Corporation, May 7, 1929")

"There were present in person or by proxy the following stockholders representing the number of shares set opposite their respective names:

Name	Name of Proxy	No. of Shares
Douglas Fairbanks	Dennis F. O'Brien.....	1000 shares
Mary Pickford Fairbanks (also known as Gladys Mary Fairbanks)	Dennis F. O'Brien.....	1000 shares
Gloria Swanson	Christopher J. Dunphy	1000 shares
Joseph M. Schenck	In Person	1000 shares
D. W. Griffith, Inc.	Albert H. T. Banzhaf....	500 shares
D. W. Griffith	Albert H. T. Banzhaf	
Samuel Goldwyn	James A. Mulvey.....	1000 shares
Art Cinema Corporation	Bertram S. Nayfaack.....	1000 shares
Charles Chaplin	Nathan Burkan	1000 shares"

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of the stockholders of United Artists Corporation at the closing of books on March 28, 1929.

The Court: It will be received as Petitioner's Exhibit 38.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 38, and made a part of this record.)

PETITIONER'S EXHIBIT No. 38

UNITED ARTISTS CORPORATION

Organized under the Laws of the State of Delaware

Alphabetical List of Stockholders

At Closing of Books on March 28, 1929

Names	Residence	Shares	
		Common	Preferred
Art Cinema Corporation	Los Angeles, Calif.....	1000	1000
Charles Chaplin	Los Angeles, Calif.....	1000	1000
Douglas Fairbanks	Los Angeles, Calif.....	1000	
Mary Pickford Fairbanks	Los Angeles, Calif.....	1000	300
Samuel Goldwyn	New York City, N. Y.	1000	1000
D. W. Griffith	New York City, N. Y.	500	
D. W. Griffith, Inc.	New York City, N. Y.	500	1000
Joseph M. Schenck	Los Angeles, Calif.....	1000	1000
Gloria Swanson	Los Angeles, Calif.....	1000	
United Artists Corporation	New York City, N. Y.	1000	
Elton Corporation			1000
Pickford Corporation			700

Correct:

ALBERT H. T. BANZHAF
Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an alphabetical list of the stockholders of United Artists Corporation at the closing of books on March, 1933.

The Court: It will be received as Petitioner's Exhibit No. 39.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 39, and made a part of this record.) [126]

PETITIONER'S EXHIBIT No. 39

UNITED ARTISTS CORPORATION

Organized under the Laws of the State of Delaware

Alphabetical List of Stockholders

At Closing of Books March 1933.

Names	Residence	Shares Common Stock
Art Cinema Corporation	729 Seventh Avenue New York City.....	1000
Charles Chaplin	1416 LaBrea Avenue Hollywood, Calif.	1000
The Elton Corporation	c/o Douglas Fairbanks Pictures Corporation P. O. Box Hollywood, Calif.	1000
Samuel Goldwyn	United Artists Studios 1041 North Formosa Ave. Hollywood, Calif.	1000
D. W. Griffith	1619 Broadway New York City.....	500
D. W. Griffith, Inc.	1619 Broadway New York City.....	500

(Testimony of Dennis Francis O'Brien.)

Names	Residence	Shares Common Stock
The Pickford Corporation	United Artists Studios 1041 North Formosa Ave. Hollywood, Calif.	1000
Joseph M. Schenck	United Artists Studios 1041 North Formosa Ave. Hollywood, Calif.	1000

Correct:

HARRY J. MULLER (in pencil)
Ass't Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from minutes of the special meeting of the board of directors of United Artists Corporation, dated August 25, 1932.

The Court: It will be received as Petitioner's Exhibit No. 40.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 40, and made a part of this record.)

PETITIONER'S EXHIBIT No. 40

(Excerpt from "Minutes of a Special Meeting of the Board of Directors of United Artists Corporation", August 25, 1932)

"It was stated to the meeting that the financial records of the corporation show that at the time of the execution of the aforesaid agreement dated November 22, 1924, all of the pre-

(Testimony of Dennis Francis O'Brien.)

ferred and common stock of the United Artists Corporation then outstanding, was owned by Mary Pickford Fairbanks, Douglas Fairbanks, Charles Chaplin, David W. Griffith and D. W. Griffith, Inc., subject to certain then existing escrow agreements pertaining to the common stock."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an alphabetical list of stockholders of United Artists Corporation at the closing of books on March 27, 1932.

The Court: It will be received as Petitioner's Exhibit No. 41.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 41, and made a part of this record.)

PETITIONER'S EXHIBIT No. 41

UNITED ARTISTS CORPORATION

Organized under the Laws of the State of Delaware

Alphabetical List of Stockholders.
At Closing of Books, March 7, 1932.

Names	Residences	Shares Common Stock
Art Cinema Corporation	729 Seventh Avenue, New York City.....	1000
Charles Chaplin	Los Angeles, California....	1000
Douglas Fairbanks	Los Angeles, California....	1000
Mary Pickford Fairbanks	Los Angeles, California....	1000

(Testimony of Dennis Francis O'Brien.)

Names	Residences	Shares Common Stock
Samuel Goldwyn	Los Angeles, California....	1000
D. W. Griffith	New York City.....	500
D. W. Griffith, Inc.	New York City.....	500
Joseph M. Schenck	Los Angeles, California....	1000
Gloria Swanson	Los Angeles, California....	1000
United Artists Corporation	New York City.....	1000

Correct:

ALBERT H. T. BANZHAF
Secretary

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from the minutes of regular meeting of the executive committee of United Artists Corporation, dated October 25, 1935.

The Court: It will be received as Petitioner's Exhibit No. 42.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 42, and made a part of this record.)

PETITIONER'S EXHIBIT No. 42

(Excerpt from page 13 of "Minutes of Regular Meeting of the Executive Committee of the United Artists Corporation held at the offices of the corporation at 729 Seventh Ave-

(Testimony of Dennis Francis O'Brien.)

nue, New York City, on the 25th day of October, 1935, at 10:30 A.M.'')

“(a) Two checks payable to Charles Chaplin in the amount of \$22,763.61 each, each check representing escrow dividends on 167 shares of common stock in the amount of \$22,266.11 and accumulated interest of \$497.50 had been delivered to Mr. Nathan Burkan October 16, 1935.”

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from minutes of [127] an adjourned annual meeting of the stockholders of United Artists Corporation held July 1, 1935.

The Court: It will be received as Petitioner's Exhibit No. 43.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 43, and made a part of this record.)

PETITIONER'S EXHIBIT No. 43

(Excerpt from “Minutes of Adjourned Annual Meeting of the Stockholders of United Artists Corporation held on July 1, 1935.”)

We, the undersigned, being the owners of all the common stock of United Artists Corporation,

(Testimony of Dennis Francis O'Brien.)

do hereby consent to the adjournment of the annual meeting of the stockholders of United Artists Corporation from the principal office of the corporation, No. 729 Seventh Avenue, New York City, New York, to the United Artists Studios, No. 1041 North Formosa Avenue, Hollywood, California, and to be held at that place on the 8th day of July, 1935 at 9 A.M. o'clock Pacific Coast Time, for all purposes and for the transaction of all business that may lawfully come before such meeting.

(signed) MARY PICKFORD

FAIRBANKS

The Pickford Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

DOUGLAS FAIRBANKS

The Elton Corporation

—Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

—Owner of 1000 shares"

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next will be an excerpt from minutes of the adjourned annual meeting of the stockholders of United Artists Corporation held July 8, 1935.

(Testimony of Dennis Francis O'Brien.)

The Court: It will be received as Petitioner's Exhibit No. 44.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 44, and made a part of this record.)

PETITIONER'S EXHIBIT No. 44

(Excerpt from "Minutes of Adjourned Annual Meeting of the Stockholders of United Artists Corporation Held on July 8, 1935.")

"The meeting was called to order by Mary Pickford Fairbanks. There were present the following stockholders:

The Pickford Corporation

by Mary Pickford Fairbanks

(proxy)

1000 shares

The Elton Corporation

by Douglas Fairbanks (proxy)

1000 shares

Charles Chaplin

1000 shares

Samuel Goldwyn

1000 shares"

(Testimony of Dennis Francis O'Brien.)

“Minutes Approved:

(signed)

MARY PICKFORD

FAIRBANKS (proxy)

The Pickford Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

R. FAIRBANKS proxy

The Elton Corporation

—Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

—Owner of 1000 shares”

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from reconvened meeting of stockholders of United Artists Corporation held on July 12, 1935.

The Court: It will be received as Petitioner's Exhibit No. 45.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 45, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 45

(Excerpt from "Reconvened Meeting of Stockholders of United Artists Corporation Held on July 12, 1935, at 9:30 o'clock in the Forenoon".)

"The Meeting was called to order by Mary Pickford Fairbanks. There were present the following stockholders:

The Pickford Corporation

by Mary Pickford Fairbanks

(proxy)

1000 shares

The Elton Corporation

by Robert Fairbanks (proxy)

1000 shares

Charles Chaplin

1000 shares

Samuel Goldwyn

1000 shares"

"Minutes Approved:

(signed)

MARY PICKFORD
FAIRBANKS

The Pickford Corporation

Owner of 1000 shares

R. FAIRBANKS

The Elton Corporation Pres

Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

Owner of 1000 shares"

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Green: The next is an excerpt from meeting of the Board of directors of United Artists Corporation held July 12, 1935. [128]

The Court: It may be received as Petitioner's Exhibit No. 46.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 46, and made a part of this record.)

PETITIONER'S EXHIBIT No. 46

(Excerpt from "Meeting of the Board of Directors of the United Artists Corporation held at the office of the corporation 1041 North Formosa Avenue, Hollywood, California, on July 12, 1935, at 11:00 o'clock in the forenoon")

"It was regularly moved, seconded and unanimously adopted that the President of the Company be authorized to enter into a five (5) year contract with The Elton Corporation, The Pickford Corporation, Charles Chaplin and Samuel Goldwyn, wherein and whereby it agrees to distribute pictures produced by each of the said stockholders or co-produced by said stockholders, or in which either Charles Chaplin, Douglas Fairbanks or Mary Pickford Fairbanks appear personally portraying prominent roles, and on the further agreement that

(Testimony of Dennis Francis O'Brien.)

each of said parties shall have the right to distribute the maximum of twelve (12) photo-plays a year through the facilities of the United Artists Corporation, terms to be substantially the same terms as now exist for so-called stockholder producers.

"It was regularly moved, seconded and unanimously adopted that as soon as Mr. Chaplin executes the aforesaid five (5) year contract, there shall be forthwith delivered to him the stock held in escrow by Dennis F. O'Brien pursuant to the old distribution agreement, and that the Treasurer of the corporation be directed to pay over to Mr. Chaplin any accrued dividends on said stock."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The section of the minutes of the board of directors of United Artists Corporation held August 19, 1935.

The Court: It will be received as Petitioner's Exhibit No. 47.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 47, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 47

(Excerpt from "Minutes of Special Meeting of the Board of Directors of United Artists Corporation, Held on Monday, August 19th, 1935, at the Hour of 4:30 o'Clock P.M.)

"The Secretary called attention of the Board to the fact that at the last meeting of the stockholders there had been discussed and approved, the question of releasing to Charles Chaplin any and all stock of this corporation now held in escrow, as well as all escrowed dividends. Whereupon, it was moved, seconded, and unanimously carried as follows:

Resolved, that United Artists Corporation immediately deliver to Charles Chaplin any and all stock of this corporation held in escrow, as well as all dividends escrowed, which stock and dividends have been escrowed pending the delivery to this corporation of further photoplays to be released by the said Charles Chaplin.

Be it further

Resolved, that the attorneys, officers and agents of this corporation be, and they are hereby instructed to notify the escrow holder of this action of the Board, and instruct him to deliver said capital stock and accumulated dividends to the said Charles Chaplin.

(Testimony of Dennis Francis O'Brien.)

Be it further

Resolved, that the officers, agents and employees of this corporation be, and they are hereby directed, empowered and instructed to do any and all other things necessary, desirable or requisite to accomplish the purpose of the above resolution."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from special meeting of the stockholders of United Artists Corporation held on September 5, 1935.

The Court: It will be received as Petitioner's Exhibit No. 48.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 48, and made a part of this record.)

PETITIONER'S EXHIBIT No. 48

(Excerpts from "Minutes of Special Meeting of the Stockholders of United Artists Corporation, held on Thursday, September 5th, 1935, at the hour of 3:00 o'clock p.m., at 1041 North Formosa Avenue, Hollywood, California.")

"The Meeting was called to order by Vice-President Mary Pickford.

(Testimony of Dennis Francis O'Brien.)

There were present the following stockholders:

The Pickford Corporation, by Mary Pickford Fairbanks, proxy, 1000 shares;

The Elton Corporation, by Robert Fairbanks, proxy, 1000 shares;

Charles Chaplin, 1000 shares;

Samuel Goldwyn, 1000 shares."

The Foregoing Minutes are approved and adopted by the undersigned stockholders.

(signed)

MARY PICKFORD

The Pickford Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

R. FAIRBANKS

The Elton Corporation Proxy

—Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

—Owner of 1000 shares"

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from minutes of special meeting of the stockholders of United Artists Corporation held January 3, 1936.

(Testimony of Dennis Francis O'Brien.)

The Court: It will be received as Petitioner's Exhibit No. 49. [129]

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 49 and made a part of this record.)

PETITIONER'S EXHIBIT No. 49

(Excerpt from "Minutes of Special Meeting of Stockholders of United Artists Corporation", January 3, 1936)

"We, the undersigned, being the owners of all the common stock of United Artists Corporation, do hereby consent to the holding of special meeting of the stockholders of United Artists Corporation, at the Los Angeles office of said corporation, 1041 North Formosa Avenue, on the 3rd day of January, 1936, said meeting having been duly called by the Secretary of the corporation as required by the By-Laws, for all purposes and for the transaction of all business that may lawfully come before such meeting, and we do hereby ap-

(Testimony of Dennis Francis O'Brien.)

prove the foregoing as a true and correct recitation of the proceedings had at said meeting.

(signed)

MARY PICKFORD

The Pickford Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

DOUGLAS FAIRBANKS

The Elton Corporation

—Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

—Owner of 1000 shares

.....

Alexander Korda.

—Owner of ... shares''

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

—————

Mr. Green: The next is an excerpt—it is a waiver of meetings of special meeting of stockholders of United Artists Corporation held January 14, 1936.

The Court: It will be received as Petitioner's Exhibit No. 50.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 50, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 50

“Minutes of Special Meeting of Stockholders of
United Artists Corporation.

WAIVER.

We, the undersigned, being the owners of all the common stock of United Artists Corporation, do hereby waive notice of a special meeting of the stockholders of said United Artists Corporation, to be held at 1041 North Formosa Avenue, Los Angeles, California, on the 14th day of January, 1936, at the hour of 1:30 o'clock P.M., and consent to the holding of the same for all purposes, and for the transaction of all business that may lawfully come before such meeting, and we do hereby ap-

(Testimony of Dennis Francis O'Brien.)

prove the following as a true and correct recitation of the proceedings had at said meeting.

(signed) MARY PICKFORD

The Pickford Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

DOUGLAS FAIRBANKS

The Elton Corporation

—Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

—Owner of 1000 shares

.....

Alexander Korda

—Owner of ... shares''

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

—————

Mr. Green: The next will be minutes of reconvened meeting of stockholders of United Artists Corporation held on July 10, 1935.

The Court: It will be received as Petitioner's Exhibit No. 51.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 51, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 51

“Reconvened Meeting of Stockholders of United Artists Corporation Held on July 10, 1935,
at 11:00 o’Clock in the Forenoon

The meeting was called to order by Mary Pickford Fairbanks. There were present the following stockholders:

The Pickford Corporation	
by Mary Pickford Fairbanks	
(proxy)	1000 shares
The Elton Corporation	
by Douglas Fairbanks (proxy)	1000 shares
Charles Chaplin	1000 shares
Samuel Goldwyn	1000 shares

On motion duly made, seconded and unanimously adopted, Mary Pickford Fairbanks was selected as Chairman of the meeting and Mr. Nathan Burkan as Secretary.

The Chairman then called the meeting for the election of officers. The following were nominated for the respective offices after their name:

Al Lichtman, President
Mary Pickford Fairbanks, First Vice-President
Harry D. Buckley, Second Vice-President
Arthur W. Kelly, Third Vice-President
Harry Muller, Treasurer
Lloyd Wright, Secretary
Harry Muller, Assistant Secretary
Edward C. Raftery, Assistant Secretary

(Testimony of Dennis Francis O'Brien.)

On motion duly made, seconded and unanimously adopted, it was directed that the Secretary cast a ballot for the election of the foregoing officers.

There being no further business to come before the meeting it was adjourned until Friday, July 12, 1935, at 9:30 A.M.

(signed) NATHAN BURKAN
Secretary

Minutes Approved:

(signed) MARY PICKFORD

FAIRBANKS proxy

The Pickford Corporation

—Owner of 1000 shares

R. FAIRBANKS proxy

The Elton Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

SAMUEL GOLDYN

Samuel Goldwyn

—Owner of 1000 shares”

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

—————

Mr. Green: The next is minutes of reconvened meeting of stockholders of United Artists Corporation held on July 9, 1935.

The Court: It will be received as Petitioner's Exhibit No. 52. [130]

(Testimony of Dennis Francis O'Brien.)

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 52, and made a part of this record.)

PETITIONER'S EXHIBIT No. 52

"Reconvened Meeting of Stockholders of United Artists Corporation Held on July 9th, 1935.

There were present the following stockholders:

The Pickford Corporation

by Mary Pickford Fairbanks
(proxy)

1000 shares

The Elton Corporation

by Douglas Fairbanks (proxy)

1000 shares

Charles Chaplin

1000 shares

Samuel Goldwyn

1000 shares

The Chairman, Mary Pickford Fairbanks called the meeting to order. Mr. Nathan Burkan continued as Secretary of the meeting. After a general discussion of the business of the corporation it was moved, seconded and unanimously adopted

(Testimony of Dennis Francis O'Brien.)
that the meeting adjourn to Wednesday, July 10th,
1935 at 9:30 A.M.

(signed) NATHAN BURKAN

Approved:

(signed)

MARY PICKFORD

FAIRBANKS proxy

The Pickford Corporation

—Owner of 1000 shares

CHARLES CHAPLIN

Charles Chaplin

—Owner of 1000 shares

R. FAIRBANKS Proxy

The Elton Corporation

—Owner of 1000 shares

SAMUEL GOLDWYN

Samuel Goldwyn

—Owner of 1000 shares''

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next one is an excerpt from minutes of first meeting of incorporators of United Artists Corporation held April 24, 1919.

The Court: It will be received as Petitioner's Exhibit No. 53.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 53, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 53

UNITED ARTISTS CORPORATION

Incorporators

First Meeting April 24, 1919

Sept. 9, 1919

Adjourned Special Meeting of Stockholders
of United Artists

Resolved that the proper officers of this corporation be and they hereby are authorized and directed to execute an escrow agreement for the holding and advancing of said 4,000 shares of non par value in accordance with the terms and provisions of said contract between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this corporation dated February 5, 1919.

Said escrow agreement to provide that while said 4,000 shares are held in escrow each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this corporation before execution of same by its officers.

Upon motion duly made, seconded and unanimously carried it was

Resolved that the shareholders of this corporation do hereby in all respects ratify a draft and

(Testimony of Dennis Francis O'Brien.)

confirm the aforesaid resolutions of the Board of Directors and the action taken or to be taken thereunder by said Board and do hereby consent to the issuance of the Common Stock of this corporation in the manner provided for in said resolutions.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: The next is an excerpt from minutes of a special meeting of the board of directors held on August 19, 1935.

The Court: It will be received as Petitioner's Exhibit No. 54.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 54, and made a part of this record.)

PETITIONER'S EXHIBIT No. 54

(Excerpt from "Minutes of Special Meeting of the Board of Directors of United Artists Corporation, held on Monday, August 19th, 1935, at the hour of 4:30 o'clock p.m.")

"The Secretary called attention of the Board to the fact that at the last meeting of the stockholders there had been discussed and approved, the question of releasing to Charles

(Testimony of Dennis Francis O'Brien.)

Chaplin any and all stock of this corporation now held in escrow, as well as all escrowed dividends. Whereupon, it was moved, seconded and unanimously carried, as follows:

Resolved, that United Artists Corporation immediately deliver to Charles Chaplin any and all stock of this corporation held in escrow, as well as all dividends escrowed, which stock and dividends have been escrowed pending the delivery to this corporation of further photoplays to be released by the said Charles Chaplin.

Be it further

Resolved, that the attorneys, officers and agents of this corporation be, and they are hereby instructed to notify the escrow holder of this action of the Board, and instruct him to deliver said capital stock and accumulated dividends to the said Charles Chaplin.

Be it further

Resolved, that the officers, agents and employees of this corporation be, and they are hereby directed, empowered and instructed to do any and all other things necessary, desirable or requisite to accomplish the purpose of the above resolution."

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

(Testimony of Dennis Francis O'Brien.)

Mr. Horner: If the Court please, I would like to immediately withdraw the last exhibit for the purpose of making copies for myself and Mr. Green. It seems to be the only copy we have.

The Court: Very well. You may do so.

Mr. Horner: I will furnish it to the Clerk before [131] the proceedings close.

Mr. Green: If your Honor please, I have one other exhibit I would like to offer in evidence, but it will be necessary for me to withdraw the original minutes from the minute book. May I be privileged to do that after the noon recess?

The Court: Very well.

Q. (By Mr. Green) Mr. O'Brien, I will show you a copy of a letter dated March 7, 1919, from John Fairbanks, treasurer, upon Douglas Fairbanks Pictures Corporation stationery, and addressed to Mr. Dennis F. O'Brien, 1482 Broadway, New York City, which contains a copy of a letter from Mr. John Fairbanks, dated March 5, 1919, to Honorable William G. McAdoo. I will ask you if you are the Mr. Dennis F. O'Brien referred to in that letter of March 7th?

A. (Examining document.) I am.

Q. Did you receive that letter from Mr. John Fairbanks on or about the date it bears?

A. I did.

Q. And did the letter that you received have enclosed with it a copy of Mr. Fairbanks' letter to Honorable William G. McAdoo dated March 5, 1919?

A. It did.

(Testimony of Dennis Francis O'Brien.)

Q. And the shares of stock therein referred to are preferred and common shares of stock of United Artists Corporation, are [132] they not?

A. They are.

Mr. Green: I would like to offer this in evidence as Petitioner's Exhibit next in order.

Mr. Horner: May I have just a moment? I haven't seen this before, and I would like to look at it first.

Mr. Green, may I ask the purpose of offering this particular document?

Mr. Green: Yes.

The purpose of offering this document is to show that each one of these five individuals, which contemplated William S. Hart at that time, was going to purchase \$100,000 worth of preferred stock in the corporation, and also, quoting from the letter itself, "and they were to get 1,000 shares each of common stock for signing the contract, thereby having the controlling interest in the corporation."

I propose to show that that 1,000 shares of each of common stock for signing the contract is the 1,000 shares of stock, Petitioner's Exhibit 4, that Mr. Chaplin received for executing Petitioner's Exhibit 5 in this case.

If your Honor please, it is further evidence of the consideration which the corporation received for the execution of this 1,000 shares of stock to Mr. Chaplin.

Mr. Horner: If your Honor please, I think I

(Testimony of Dennis Francis O'Brien.)

shall [133] object to the document being received in evidence. It is written by a man who is not in court, and there is some expression of opinion in here which seems to me to be in the nature of a conclusion and bears very vitally upon the very issue in this case.

The Court: Well, it will not be binding upon us. I think it probably is competent evidence for a limited purpose, at least.

Mr. Horner: The writer, you understand, of course, is not here, and probably won't be here.

The Witness: He is dead, John is.

Mr. Horner: Yes.

It seems to me the communication is inadmissible for that reason.

The Court: It will not be taken in as proof of any facts to which it may relate, but it is simply showing a part of the chain of events leading up to the organization of Petitioner. It will be received as Petitioner's Exhibit No. 55. The objection will be overruled.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 55, and made a part of this record.)

(Testimony of Dennis Francis O'Brien.)

PETITIONER'S EXHIBIT No. 55

DOUGLAS FAIRBANKS PICTURES
CORPORATION

Hollywood, California

March 7, 1919

Mr. Dennis F. O'Brien
1482 Broadway
New York City

Dear Cap:

Enclosed find copy of a letter written and delivered to Mr. McAdoo as he was leaving California for New York. As you are to be one of the directors of the new distributing corporation, will you please use your very best endeavor to see that the provisions of this letter are carried out.

Thanking you, as ever,

Sincerely,

JNO FAIRBANKS

Treasurer.

DOUGLAS FAIRBANKS PICTURES
CORPORATION

Hollywood, California

Office of the Treasurer—Copies

March 5, 1919

Honorable William G. McAdoo

Santa Fe Train No. 2 enroute

to New York, Car No. 31

Dear Mr. McAdoo:

At a conference between the four stars yesterday, a very essential matter pertaining to the new organ-

(Testimony of Dennis Francis O'Brien.)

ization was discussed and they desired me to present same to you.

It was the original understanding that there would be five stars in the combine prior to Mr. Hart's withdrawal. At that time the plan was that there be nine-thousand (9000) shares of common stock with no par value and five-thousand (5000) shares of preferred stock which was to be subscribed for at \$100.00 per share. Each one of the five stars were to subscribe for one-hundred thousand dollars (\$100,000.00) worth of this preferred stock and they were to get one thousand (1000) shares each of common stock for signing the contract, thereby having the controlling interest in the corporation. Mr. Hart having withdrawn from the combine, it has been agreed by the remaining four artists that they take over the \$100,000.00 worth of preferred stock left by Mr. Hart in equal shares of \$25,000.00 each, making a total of preferred stock to each artist of \$125,000.00 and that therefore, they should receive an additional amount of two hundred and fifty (250) shares of common stock each, making a total to each artist of twelve hundred and fifty (1250) shares of common stock, thereby keeping control of the corporation in their own hands at all times.

They desired me to make this point clear to you so that there might be no misunderstanding when Mr. Cotton draws up the agreement and I trust same will meet with your approval.

Please accept my sincerest sympathy over your

(Testimony of Dennis Francis O'Brien.)

recent loss and trust that your daughter and her baby will continue to improve right along.

With best wishes for Mrs. McAdoo and yourself for a safe and pleasant journey and hoping that you will be back in California in the very near future, I remain,

Very sincerely,

(signed) JOHN FAIRBANKS

Treasurer.

JF:HG

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: That is all, Mr. O'Brien.

If Your Honor please, that is all of the questions of Mr. O'Brien at this time, but may we be privileged to recall [134] him at a later date?

The Court: Yes.

Off the record.

(Discussion outside the record.)

The Court: On the record.

We will suspend at this time until 2:00 p. m.

(Whereupon, at 12:20 o'clock p. m., a recess was taken until 2:00 o'clock p. m. of the same date.) [135]

Afternoon Session

2:00 P. M.

The Court: Proceed.

DENNIS F. O'BRIEN

the witness on the stand at the time of recess, resumed the stand, and further testified as follows:

Direct Examination

(Continued)

Q. (By Mr. Green) Mr. O'Brien, I show you a minute book of United Artists Corporation covering the year 1930, and I would like to call your particular attention to minutes of a special meeting of the board of directors of United Artists Corporation held on August 6, 1930, at which there were present the following directors: Dennis F. O'Brien, Albert H. T. Banzhaf, James A. Mulvey, Bertram S. Navage, Nathan Burkan, Harry D. Buckley, and Christopher J. Dunfy, particularly now to page 2, where it recites that "the chairman then stated that the meeting had been called for the purpose of authorizing Mr. Dennis F. O'Brien to execute an affidavit with regard to the ownership by the United Artists Corporation of the shares of stock of United Artists Corporation, Ltd., the English subsidiary of the United Artists Corporation."

Now, following that statement is this resolution: "Resolved, that the act of Mr. Dennis F. O'Brien on July 25, 1930 in signing an affidavit setting forth the facts with respect to the ownership of stock of the United Artists [136] Corporation, Ltd., the English subsidiary corporation of this company,

(Testimony of Dennis Francis O'Brien.)

being the same, is hereby ratified and approved in all respects. A copy of said affidavit signed by Mr. Dennis F. O'Brien was directed to be filed with the minutes of this meeting."

Now, I will show you an executed affidavit bearing the date of July 25, 1930, signed by Dennis F. O'Brien, and I will ask you if that is the affidavit that you prepared on that occasion.

A. It is.

Q. And this is the affidavit that was placed in the minute book of the corporation immediately following the minutes to which I have just referred?

A. That is correct.

Q. And this affidavit relates to the matters recited in those minutes, does it not?

A. Yes.

Q. And this affidavit also relates to the issuance and ownership of the shares of common stock of the United Artists Corporation, does it not?

A. Yes, sir.

Mr. Green: If your Honor please, at this time I offer the affidavit in evidence as Petitioner's Exhibit next in order, and I would like to make this suggestion in connection with the offer, that there are only two para- [137] graphs in the affidavit which I consider material. I would prefer to read those two paragraphs into the record rather than offering the entire affidavit.

Mr. Horner: I would like to object to the admission in evidence of the offer, your Honor, on the grounds that it is irrelevant and immaterial, and

(Testimony of Dennis Francis O'Brien.)

the affidavit in question relates to an English tax in controversy with the Government of Great Britain, and it contains an expression of opinion of Mr. O'Brien which your Honor ruled out this morning, namely, about the ownership of stock. I am confident, of course, that it is a resolution as he has read it, and I have no quarrel with the best evidence rule, or anything of that kind.

Mr. Green: If your Honor please, in Petitioner's Exhibits that have already been offered in evidence in this case there are many references to the owners of the common shares of stock of United Artists Corporation. In fact, many of those exhibits specifically recite who the owners are and use the word "ownership" in connection with them. Now, these portions of the affidavit to which I have referred, paragraphs 9 and 10 bear on this same subject matter. Not only that, if your Honor please, the affidavit also relates to the fact that the shares of stock when issued were deposited as security for the performance of the contract. Now, that is just exactly what Petitioner [138] claims happens in this case. In the affidavit it recites that it was made on behalf of United Artists Corporation and as its act. Consequently, I claim that is highly material and since other evidence has already been introduced regarding the same facts, I can't see but what it is competent evidence.

Another thing, Mr. Horner, I believe you will find that the affidavit relates to the ownership of certain shares of stock and does not relate to a tax situa-

(Testimony of Dennis Francis O'Brien.)

tion. That is the substance of the affidavit, as I construe it.

Mr. Horner: I may have been partly wrong in stating it related to a controversy with England over taxes, but it does relate to a controversy with the country of Great Britain, and, as I read the affidavit, does contain an expression of Mr. O'Brien's opinion about ownership.

The Witness: May I explain that, your Honor?

The Court: No. Not at this time.

Well, I indicated this morning that I couldn't see very much relevancy or any reason for accepting an affidavit of the very witness that we have present here at the hearing, but inasmuch as it is a part of the minutes of the corporation it might have a limited evidentiary value, though, as I stated this morning, a statement of any witness to the ultimate fact which we ourselves must find is not very helpful. His opinion that somebody had the [139] ownership of the stock is perhaps not very helpful. What we will have to do is find what the facts actually are and from that make our own conclusion.

Mr. Green: Yes, I appreciate that, your Honor.

The Court: Well, it was marked this morning as Petitioner's Exhibit No. 16. It will be received in evidence as Petitioner's Exhibit No. 16 for a rather limited purpose.

Mr. Horner: May I have an exception to your Honor's ruling?

The Court: An exception may be noted.

Mr. Horner: Mr. Green has just tendered two

(Testimony of Dennis Francis O'Brien.)

paragraphs. I think the whole affidavit ought to go in, if any part of it goes in.

The Court: There was a copy handed to the Clerk this morning and marked as Petitioner's Exhibit No. 16 for identification.

Mr. Green: It will now be Petitioner's No. 16.

The Court: We will receive it for a limited purpose.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 16, and made a part of this record.)

PETITIONER'S EXHIBIT No. 16

Affidavit of Mr. Dennis F. O'Brien

State of New York

County of New York—ss.

I, Dennis F. O'Brien, a Counsellor and Attorney-at-law, of 152 West 42nd Street, New York City, New York, U.S.A., being first duly sworn, on oath depose and state as follows:

1. I am both a Director of and the Attorney-at-law for the United Artists Corporation, a company incorporated under the Laws of the State of Delaware, U.S.A., and hereinafter called "the American Company", and am also a Director of the Allied Artists Corporation, Ltd., the registered office of which is situate at 142, Wardour Street, in the County of London (the name of which has been

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

changed to United Artists Corporation Limited and is hereinafter called "the English Company"), and I am duly authorized to make this affidavit on behalf of each of the said Companies.

2. I am advised that, having regard to the British Finance Acts 1922 and 1927, as a Director of the English Company, I should make, and I hereby make, an affidavit as to the following facts:

3. Mr. F. M. Guedalla, who is a Director and Solicitor of the English Company, has sent me his letters addressed to the Clerk to the Special Commissioners, of November 14, 1928 and November 5, 1929, from which letters I observe that he labors under a confusion as to certain relevant facts, which I beg herein to correct.

4. The confusion, as I understand it, arises by reason of conversations which I or Mr. Burkan, who is one of the Directors of the American Company, and Counsellor for Mr. Chaplin and Mr. Chaplin's concerns, have had with Mr. Guedalla in former years; we were discussing the difficulties and uncertainties connected with the stock of the American Company through the arrangements made with regard to the holdings of such stock, but Mr. Guedalla understood that the said arrangements extended to the English Company. This is not and never has been the case.

5. At the same time, Mr. Guedalla is correct in one respect, namely, that some of the persons interested in the stock of the American Company did

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

at one time raise a question whether the shares of the English Company should not belong to them, instead of to the American Company; but as I hereinafter explain, all the shares of the English Company, from the outset and down to date, have always belonged to the American Company and to nobody else.

6. The American Company was formed on May 21, 1919. The Preferred Stock, which was redeemed in 1930 under the provisions of the Company's resolutions as and when issued, was registered in the names of the following stockholders:

Charles Chaplin	\$100,000
Douglas Fairbanks	30,000
Elton Corporation	70,000
Mary Pickford Fairbanks.....	30,000
Mary Pickford Corporation.....	70,000
D. W. Griffith Inc.....	100,000
Samuel Goldwyn, Inc.....	75,000
Joseph M. Schenck.....	100,000
Art Cinema Corporation.....	100,000

All of the said Preferred Stock was held by them in March, 1924, and continued to be so held until redeemed. In addition to that, Miss Gloria Swanson and her Producing Corporation, had agreed in 1925 to subscribe \$100,000 Preferred Stock, but the agreement was superseded by other arrangements made subsequently.

7. In the case of some of the individuals above named, I believe that they in fact hold some or all or the said Preferred Stock beneficially for their

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

Producing Corporations, but it is not in my province to be acquainted with such details.

8. When the American Company was incorporated, it was agreed to give to Mr. William Gibbs McAdoo, formerly Treasurer in the Cabinet of the U. S. A. and who took part in legal services for the American Company, 1,000 shares of Common Stock of no par value. The Company redeemed these shares in 1920, and subsequently in 1924, issued them to Mr. Joseph M. Schenck.

9. In 1924 the American Company issued to Mr. Charles Chaplin, Mr. Douglas Fairbanks and Mrs. Mary Pickford Fairbanks and Mr. D. W. Griffith, each of them 1,000 shares of Common Stock of no par value. Mr. D. W. Griffith subsequently transferred 500 of his shares to D. W. Griffith, Inc. a corporation incorporated according to the Laws of the State of Maryland, U.S.A., and at a later date he transferred his remaining 500 shares to that corporation. Mr. and Mrs. Fairbanks held some of their Common Stock on behalf of their Producing Corporations.

10. When the American Company was incorporated, the Artists, for themselves and their Producing Corporations, entered into agreements to deliver an agreed number of films over an agreed period of years, and as some security for their fulfilling this obligation, it was arranged that all their shares of Common Stock should be deposited with me to be held by me in escrow and as and when the

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

films from time to time were delivered, I released the shares of Common Stock to them, or as directed by them. The said shares at all material times belonged to and were in the names of the said stockholders. In certain cases, some of the artists were in default in delivery for a considerable time.

11. Mr. Joseph M. Schenck joined the American Company and became a stockholder on November 22, 1924, and took the said 1,000 shares of Common Stock, entering into similar escrow agreement for delivery of films.

12. Mr. Schenck represented two large concerns—Joseph M. Schenck Productions Inc. and Art Cinema Corporation—both Companies being incorporated and carrying on business in the U.S.A. Shortly afterwards, another company in which he is interested, viz., Feature Productions, Inc., also incorporated and carrying on business in the U.S.A., joined the United Artists.

13. Gloria Swanson entered into agreements with the American Company on behalf of herself and Gloria Swanson Productions, Inc., an American Company, and thereunder became on July 15, 1925 entitled to 1,000 shares of Common Stock of no par value. These shares, as in the case of Mr. Schenck, were also deposited with me in escrow.

14. Mr. Samuel Goldwyn became a stockholder, both as regards Preferred Stock and Common Stock, by agreement on August 29, 1925 and entered into agreements representing Samuel Gold-

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

wyn, Inc., also incorporated in and carrying on business in the U.S.A., and while he and his company were in course of delivering the agreed films to the American Company for distribution, I held his Common Stock in escrow.

15. Mr. Hiram Abrams, who for many years had been President of the American Company, died at the end of 1926. Mr. Joseph M. Schenck succeeded him as President of the American Company.

16. In 1920, one Morris Greenhill entered into an agreement with the American Company for the distribution of its films in the British Isles and deposited with the American Company \$100,000. He failed to perform his obligations and the said deposit was forfeited.

17. In consequence of the failure by the said Greenhill to carry out his obligations as aforesaid, it was decided that an English Company should be formed in order to distribute the said films in the British Isles. The American Company utilized part of the said money for subscribing the 7,500 shares of this English Company which was incorporated on March 15, 1921, with the said object.

The American Company has never limited itself to the films of the said artists and their producing corporations, but often acquires other films, and if it has the British rights to same, sub-licenses the English Company for the purposes of distribution.

18. The American Company had in the course of its business sustained a large loss in connection with

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

one of Mr. Griffith's films, and had been indemnified against such loss by Mr. Chaplin and Mr. and Mrs. Fairbanks. It was under the arrangements made to effectuate such indemnity that on October 17, 1928 the said four persons, and in the case of two of them, their producing corporations, relinquished to the American Company all their title and interest to and in the said film, and inasmuch as at one time they had put forward some claim to the shares of the English Company, it was thought advisable to include a surrender to the American Company of such claims. The American Company relieved and released these four persons and their said producing corporations from guarantees which they had given in regard to the said film.

19. A copy of the said minutes of October 17, 1928 was sent to Mr. Guedalla for his information, and he informs me that he inferred therefrom that the artists and their Producing Corporations were the beneficial owners of the shares of the English Company. But this is not the case. There had been some talk at different times that they were entitled to Mr. Greenhill's forfeited deposit, and therefore to the investment thereof. These claims were never pressed or taken seriously but the Directors and legal advisers of the American Company took the opportunity on October 17, 1928 to put the matter beyond any possible doubt.

20. The shares of the English Company have always been registered in the names of nominees.

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

Originally the seven signatory shares were registered in the names of Mr. F. M. Guedalla, and six employees of his firm. The remaining 7493 shares were registered in the name of the First Managing Director of the English Company, and of Mr. F. M. Guedalla, jointly. There have been various Managing Directors, and whenever there has been a new Managing Director, the shares were registered in the joint names of the Managing Director for the time being of the English Company; and of Mr. F. M. Guedalla.

One of the Mr. Guedalla's clerks has left him, and his signatory share has been transferred into another name, namely the name of Mr. Tindall has been substituted by the name of Mr. Vincent Carl Daviss.

21. The instructions given to Mr. Guedalla originally, with which he has always complied, were to see that the certificates and blank transfers were deposited in the name of the American Company with the London Branch of the Guaranty Trust Company of New York, who in fact are the bankers of the American Company.

22. No one had any authority to withdraw the said certificates and transfers from the Guaranty Trust Company except on the authority of Mr. Hiram Abrams, President of the American Company. Mr. Hiram Abrams died in 1926, and since his death the Guaranty Trust Company have only been entitled to act on resolutions of the Board

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

of Directors of the American Company. No one else has or ever had any authority to deal with any of the said shares.

23. The beneficial ownership of the shares of the English Company has always been in the American Company, and no one else. The English Company was formed, as I have stated, with money provided by, and belonging exclusively to, the American Company.

24. The shares of the English Company have always been listed in the balance sheet of the American Company as its property and among its assets, and have never been treated as held for or belonging to anyone else.

In deposing and making the foregoing statement in affidavit form, as is permissible under our local law, I do so with the conscientious belief that it has the same force and effect as a statutory declaration such as that provided for in the British Statutory Declarations Act of 1835, and I do state that

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

the contents of my foregoing statement are true to the best of my knowledge, information and belief.

DENNIS F. O'BRIEN

Director of and Attorney-at-law for the

UNITED ARTISTS CORPORATION

(The American Company)

Subscribed and sworn to before me this 25 day of July, 1930.

ELIZABETH A. REILLY

Notary Public.

New York County Clerk No. 341 etc.

Seal of British Consulate General

New York

No. 30775 Series C

State of New York,

County of New York—ss.

I, Daniel E. Finn, Clerk of the County of New York, and also Clerk of the Supreme Court for the said County, the same being a Court of Record, having a seal, Do Hereby Certify, That Elizabeth A. Reilly whose name is subscribed to the deposition or certificate of the proof or acknowledgment of the annexed instrument, and thereon written, was, at the time of taking such deposition, or proof and acknowledgment, a Notary Public in and for such County, duly commissioned and sworn, and authorized by the laws of said State, to take depositions

(Testimony of Dennis Francis O'Brien.)

Petitioner's Exhibit No. 16 (Continued.)

and to administer oaths to be used in any Court of said State and for general purposes; and also to take acknowledgments and proofs of deeds, of conveyances for land, tenements or hereditaments in said State of New York. And further, that I am well acquainted with the handwriting of such Notary Public and verily believe that the signature to said deposition or certificate of proof or acknowledgment is genuine.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of the said Court and County, the 25 day of July, 1930.

[Seal]

DANIEL E. FINN

Clerk

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

Mr. Green: You may cross examine, Mr. Horner.

Cross Examination

Q. (By Mr. Horner) Mr. O'Brien, you stated this morning [140] on direct examination that upon the distribution to Mr. Chaplin of the certificates of stock for 334 shares and dividends that the sum of interest was also paid to Mr. Chaplin. Was that interest paid by the corporation, or did that represent the interest paid by the bank for the deposit and use of those dividends? A. I can't—

Mr. Green (Interrupting): Mr. Horner, we will stipulate that it was paid by the bank.

(Testimony of Dennis Francis O'Brien.)

Mr. Horner: Paid by the bank?

Mr. Green: Yes.

Mr. Horner: That is all right.

Q. Mr. O'Brien, was the certificate of stock issued to Mr. McAdoo and delivered to him at any time prior to the severance of his connection with the corporation? A. Yes.

Q. As counsel in April, 1930? A. Yes.

Q. When were those certificates delivered to Mr. McAdoo?

A. About the same time that all of the stock was delivered.

Q. Well, I don't think there is any evidence in the record so far showing delivery to the other artists.

A. Yes. It was delivered on September 7th of that year, 1929.

Q. September, 1919? [141]

A. The same date as Oscar Price's letter, who was the president, delivered the certificate to me.

Q. Were Mr. McAdoo's certificates of stock ever held in escrow by the corporation or by you?

A. No.

Q. Never were? A. Never were.

Q. And as I understand you, this morning you said that he had discontinued his services with the corporation about April, 1930?

A. About that time.

Q. April, 1920, I meant to say.

A. Yes. At the first annual meeting he withdrew and we purchased his stock. I say "we," the

(Testimony of Dennis Francis O'Brien.)

United Artists purchased the stock and assumed an obligation that Mr. McAdoo had in connection with the production of the motion picture "Romance" which he had negotiated.

Q. But prior to his withdrawal from the company as general counsel, the certificates of stock for 1,000 shares of the United Artists Corporation had been delivered by Mr. McAdoo?

A. That is correct.

Q. And they never were in escrow by you or by the corporation?

A. They were never in escrow. [142]

Mr. Horner: That is all.

Mr. Green: That is all, Mr. O'Brien.

(Witness excused.)

Mr. Green: Mrs. Watt.

LOIS E. WATT

a witness on behalf of Petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Green) Will you state your full name, please? A. Lois E. Watt.

Q. Mrs. Watt, what is your business or occupation?

A. Bookkeeper and secretary and treasurer.

Q. For whom?

A. The corporation's and also Mr. Chaplin.

(Testimony of Lois E. Watt.)

Q. Mr. Chaplin personally? A. Yes.

Q. How long have you been in his employ?

A. Since 1920.

Q. You were in his employ during the year 1935?

A. Yes, I was.

Q. During the year 1935 did Mr. *Chaplin* dividends in the amount of \$44,532.22, being dividends on 334 shares of stock of United Artists Corporation? A. Yes, he did. [143]

Q. And those dividends were paid over to him at the time 334 shares of the common stock of United Artists Corporation were delivered to him?

A. Yes, they were.

Q. Now, at the time those dividends were received did Mr. Chaplin also receive interest on those dividends? A. Yes, he did.

Q. What was the amount of that interest?

A. \$995, I believe.

Q. \$995?

The Court: \$995?

Q. (By Mr. Green) Is that right?

A. Yes.

Q. Now, did you supervise the preparation of Mr. Chaplin's 1935 Federal income tax return?

A. Well, it was taken from the records which I kept by Price Waterhouse.

Q. Do you know of the said sum of \$995, whether or not that was included in the tax return as interest income? A. Yes, it was.

Q. And was the tax paid on that income?

A. Yes, sir.

(Testimony of Lois E. Watt.)

Q. Mrs. Watt, you are familiar with a claim for refund that was filed with the Federal Government involving the dividend of \$44,532.22, which I just referred to? [144] A. Yes, I am.

Q. And upon what date was that claim for refund filed?

A. Well, I have it on my record here. I believe it was August of 1935, was it?

Q. Will you look at the record?

A. I will look at my record and be sure. I didn't memorize it offhand.

March 8, 1939.

Mr. Green: You may examine, Mr. Horner.

Mr. Horner: I have no questions.

(Witness excused.)

Mr. Green: I would like to call Mr. White.

J. R. WHITE

a witness on behalf of Petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Green) Will you state your full name, please? A. J. R. White.

Q. Mr. White, where do you live?

A. Glendale, California.

Q. And what is your business or occupation?

A. I am a public accountant with Price Waterhouse and Company.

(Testimony of J. R. White.)

Q. And how long have you been a public accountant? [145] A. 15 Years.

Q. And Price Waterhouse and Company, are they the auditors for Mr. Charles Chaplin?

A. They are.

Q. And how long have they been acting in that capacity? A. Since 1927.

Q. And have you been employed by Price Waterhouse and Company since 1927? A. Yes.

Q. As a representative of Price Waterhouse and Company, Mr. White, have you been supervised, or have the annual audits of the books of Mr. Charles Chaplin been made under your direction and control?

A. In certain years; not for all years, no.

Q. Was the audit for the year 1931 made under your direction and control?

A. Not the audit, no, sir.

Q. Do you have working papers in connection with the audit for the year 1931? A. Yes, sir.

Q. Now, I will ask you if any dividends were paid by United Artists Corporation to Mr. Charles Chaplin, or any dividends were delivered to Mr. Charles Chaplin in the year 1931 by United Artists Corporation in connection with any shares of common stock which had previously been held in escrow. [146]

A. Well, Mr. Chaplin's records show that in 1931 in February he received \$5,000 in dividends on stock which had been released to him from escrow, and also that he received \$4,980 in dividends

(Testimony of J. R. White.)

in respect of 167 shares of stock which were released to him in 1931.

Q. And do you recall in connection with what picture those 167 shares of stock were released to Mr. Chaplin in 1931?

A. Mr. Chaplin's records show that that was released upon delivery of the negative to "City Lights."

Q. Now, did you have charge of the preparation of Mr. Chaplin's income tax return for the year 1931?

A. Yes, it was prepared under my direct supervision.

Q. And were those dividends that were delivered to Mr. Chaplin at the time the 167 shares of stock were released from escrow reported in Mr. Chaplin's 1931 income tax return?

Mr. Horner: Your Honor, I object to that question on the grounds it is irrelevant and incompetent. We have the year 1935; not 1931. I don't see how it can be material.

Mr. Green: If your Honor please, I claim it is material in this respect, that throughout a number of years, and as Mr. Chaplin produced pictures from time to time and released them to United Artists Corporation and received a release of his stock from escrow, that he did not report those shares of stock as constituting income, [147] that he didn't consider them as income, and that the Government never took exception to the manner

(Testimony of J. R. White.)

in which he reported either the stock certificates or the dividends.

The Court: What difference would that make?

Mr. Green: It would have a bearing for this reason: Mr. Chaplin had a tax controversy in connection with the year 1931, the year in which these particular dividends were received. His returns and his books for that year were thoroughly audited. It was made known to the Respondent the nature of those dividends, their sources and everything else, and the Respondent in that year allowed them to be taxed as dividend income, while in 1935 when we have an exact situation they are now attempting to say that they should be treated and taxed as ordinary income.

The Court: There isn't anything pleaded in the way of estoppel, is there?

Mr. Green: No, your Honor.

The Court: There has been no adjudication of the matter so that there is any *res adjudicata*.

Mr. Green: There has been a final settlement of his 1931 tax.

The Court: That wouldn't be *res adjudicata*.

Mr. Green: I don't believe it would.

The Court: I fail to see where it is at all material. [148] I will sustain the objection.

Mr. Green: May we have an exception?

The Court: Exception may be noted.

Mr. Green: That is all, Mr. White.

Mr. Horner: No questions, Mr. White.

(Witness excused.)

Mr. Green: Mr. Chaplin.

CHARLES SPENCER CHAPLIN

a witness in his own behalf, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Wright) Did you state your name?

A. Charles Chaplin, Charles Spencer Chaplin.

Q. You are the Petitioner in this matter?

A. Yes.

Q. What is your business or occupation, Mr. Chaplin?

A. I am a producer of motion pictures and an actor.

Q. How long have you been engaged in the motion picture business?

A. Approximately, oh, 27 years.

Q. Since on or about 1914? A. Yes.

Q. Were you one of the originators of United Artists Corporation in 1919? [149] A. Yes.

Q. Who were the other originators?

A. Douglas—Mary Pickford, Douglas Fairbanks, D. W. Griffith, I think, and myself.

Q. What were the purposes for which United Artists Corporation was organized, Mr. Chaplin?

A. It was for the purpose of independence, which would give us an opportunity of keeping faith with the public to make the best pictures we possibly could without the curtailment of any trust or organization, and also to thwart any trust movement on the part of the industry which was about to take place at that time.

(Testimony of Charles Spencer Chaplin.)

Q. In other words, it was for the purpose of controlling the production of your respective photoplays and for having a release of your own ownership, is that correct? A. Yes.

Q. Were you under contract to produce photoplays for distribution for First National Pictures in 1919? A. Yes.

Q. And is it a fact that because of your contract with First National your United Artists contract provided for a later date of delivery of your photoplays than for the delivery of the photoplays of the others? A. Yes, it did.

Q. When did you complete the production of photoplays for [150] distribution by First National Pictures?

A. I don't know the exact date. I think there is a record of it.

Q. Was "The Pilgrim" the last photoplay you made for First National distribution?

A. I am not sure. I believe so. I think there was another picture issued. I am not quite sure. I am not positive.

Q. It was on or about 1922 that you completed your commitment, whatever it was, for First National Pictures distribution?

A. Yes, I think so. I believe so.

Q. Were you able to perform any services in connection with the photoplays made for United Artists release prior to the time that you completed the last photoplay released by First National Pictures, Incorporated? A. No.

(Testimony of Charles Spencer Chaplin.)

Q. Now, prior to February, 1919, Mr. Chaplin, what length motion pictures had you been producing?

A. Oh, two and three reels; no more; with the exception of "The Kid," with the exception of "The Kid," which was an exceptional subject matter, and I think that was about six reels, and "The Pilgrim," which was also a five reel picture.

Q. You have heard Dennis O'Brien testify this morning? A. Yes. [151]

Q. You heard reference to the agreement of February 5, 1919, which is Petitioner's Exhibit 1. You heard Captain O'Brien testify to it?

A. Yes.

Mr. Wright: I think, Mr. Horner, if I may be privileged to ask him without reference to it.

Mr. Horner: That is all right.

Q. (By Mr. Wright) That contract called for photoplays of from 16— to 3,000 feet in length. I will now ask you if any of the photoplays which you produced and released through United Artists Corporation were of 1600 to 3000 feet in length.

A. No.

Q. They were all longer photoplays?

A. Much longer.

Q. Why did you change the length of the photoplay that you produced?

A. Oh, it was the subject matter I thought warranted of a longer length, and I wasn't restricted to, as I thought, to any time; and I suppose it was the subject matter.

(Testimony of Charles Spencer Chaplin.)

Q. Now, you delivered these photoplays to United Artists for distribution under your distribution contract dated February 5, 1919?

A. Yes.

Q. And there was no other contract or amendment or arrangement made? They accepted it, the photoplays, even [152] though they were of a greater length, isn't that true? A. Yes.

Q. When you were contemplating the organization of United Artists Corporation, is it true that you set forth in the contract that you would make nine short reel pictures because of your past experience in making the short pictures?

A. Yes, it was based on that.

Q. And it is also true that "The Kid" and "The Pilgrim" were produced by you subsequent to the signing of this contract of February 5, 1919? A. I believe that is so.

Q. Introduced as Petitioner's Exhibit 1.

Mr. Chaplin, was there any discussion between you and United Artists Corporation or any of the other stockholders at the time of the expiration of the three year period called for in your contract with reference to delivery back to United Artists of the 1,000 shares of common stock previously issued you and deposited with Captain O'Brien because you had not delivered any photoplay? A. No.

Q. Referring now, Mr. Chaplin, to the negotiations leading up to the formation of United

(Testimony of Charles Spencer Chaplin.)

Artists, did those negotiations endure for a number of months? A. They did, yes. [153]

Q. And in the conferences and negotiations, did Miss Pickford, Mr. D. W. Griffith, Mr. Fairbanks, Mr. Dennis F. O'Brien, and Mr. Sydney Chaplin and Mr. Nathan Burkan, Senator McAdoo and Mr. Cotton and Mr. Franklin all participate?

A. Yes.

Q. Do you recall any other names or the names of any other persons who participated in those negotiations? A. I don't.

Q. Now, was it the result of the negotiations carried on with these people just mentioned that you executed the agreement of February 5, 1919 introduced as Petitioner's Exhibit No. 1?

Mr. Horner: Just a moment. Will you read that question, Mr. Reporter?

(The question referred to was read by the reporter, as set forth above.)

Mr. Horner: I object to that question, your Honor, on the grounds it is a leading question.

Mr. Wright: I am trying to conserve time.

The Court: Overruled.

Q. (By Mr. Wright) I will show you the exhibit.

A. (Examining document.) Yes.

Q. You testified, Mr. Chaplin, that you were present during the testimony of Mr. O'Brien all day today? [154] A. Yes.

Q. Has Mr. O'Brien to the best of your recol-

(Testimony of Charles Spencer Chaplin.)

lection given the substance of the negotiations which led up to the formation of United Artists Corporation?

A. Yes, as I remember them.

Q. Do you recall now any other phases of the negotiations which were not covered by Mr. O'Brien?

A. No, I don't. I think, as I say, the question of the 1,000 shares of common stock, putting them in escrow, was a part of goodwill and an added security for the company in order that we would carry out the terms of our signed contract distributing pictures.

Q. That stock was issued in your name in 1919, was it not, Mr. Chaplin?

A. Yes.

Q. And ever since that time you have exerted all control over that stock?

A. Yes.

Q. As a stockholder?

A. Yes.

Q. You have from time to time attended stockholders' meetings personally?

A. Yes.

Q. Or by proxy, and always voted 1,000 shares?

A. I have always voted equally with the other members of [155] the stockholders, of the stockholder members.

Q. Mr. Chaplin, do you remember negotiations in 1920 held among the owners of United Artists Corporation, owners of the stock of United Artists Corporation, and a banking firm known as Dillon, Reid and Company?

A. I do.

Mr. Horner: I object to that as leading, and it assumes facts not in evidence.

(Testimony of Charles Spencer Chaplin.)

The Court: Well, of course, it is a little leading. Ordinarily that, of course, doesn't make much difference. We haven't had that name before in this record. I don't know what there is about it. We will permit him to answer the question. Proceed. It is preliminary.

Q. (By Mr. Wright) Did you answer the question, Mr. Chaplin? A. What is the question?

(The question referred to was read by the reporter, as set forth above.)

The Witness: Yes, I do.

Q. (By Mr. Wright) In these negotiations, Mr. Chaplin, did they discuss with you in your presence and with your co-owners of United Artists Corporation the purchase of the common stock of United Artists Corporation?

A. Whom do you mean?

Q. Representatives of Dillon & Read and Company. [156] A. Yes.

Q. Were you to receive any portion of the purchase price of said stock? A. Yes.

Q. What proportion?

A. I think it was the same proportion as the rest of the stockholders.

Q. In other words, it was contemplated that all owners of stock would receive a like amount of money, is that correct? A. Yes.

Q. Mr. Chaplin, do you recall the issuance of the stock, of the common stock, in 1919, which was deposited with Mr. O'Brien under the agreement?

(Testimony of Charles Spencer Chaplin.)

A. No, I don't really recall it, the exact time.

Q. Do you recall there was 1,000 shares of common stock issued in your name?

A. Yes, oh, yes.

Q. What did you pay for that stock?

A. Well, I think we paid something like \$35,000.

Q. I am afraid I have confused you, Mr. Chaplin.

At the same time that the common stock was issued, did you subscribe for preferred stock of United Artists Corporation?

A. I don't quite remember. I don't know. You see, my [157] brother and all my other associates attended to that business more or less. I don't know whether we had the common stock first or the preferred stock. I wouldn't quite know. I don't quite understand the question, as a matter of fact; and I must say that I never saw the actual stock. I knew that it was put in my name and put up in escrow. They told me that I had 1,000 shares of common stock. When that was, whether it was prior to the preferred stock or not, I don't know.

Q. Well, do you recall what the consideration was for the issuance of the common stock?

A. For the signing, yes, for the signing—making a contract with the company.

Q. The distribution contract?

A. Distribution contract.

Q. And at the same time, Mr. Chaplin, did you

(Testimony of Charles Spencer Chaplin.)

subscribe to any preferred stock of United Artists Corporation? A. I think so, yes.

Q. Mr. Chaplin, you have testified that you have been in the motion picture business since 1914. Tell us, if you will please, the standing of Miss Mary Pickford in the motion picture industry just prior to and as of February, 1919.

Mr. Horner: If your Honor please, I would like to object to that question as wholly immaterial to any [158] issue in this case.

Mr. Wright: May it please the Court, it is directed towards the consideration going to United Artists Corporation for the issuance of common stock. Part of the consideration under the terms of the February 5, 1919, agreement was the execution by each of the organizers, excepting Mr. McAdoo, of a distribution contract, the subscription of preferred stock, and it is pertinent, in our opinion, to show that a goodwill, a tremendous goodwill, was the result of these outstanding people contracting with United Artists Corporation.

The Court: Well, Mr. O'Brien so testified this morning, and Mr. Chaplin has more or less repeated the testimony by proxy, but if you have anything else to add, I will permit him to answer. The objection will be overruled.

Q. (By Mr. Wright) Will you answer the question, Mr. Chaplin?

A. What was the question?

Mr. Wright: Will you read the question, Mr. Reporter?

(Testimony of Charles Spencer Chaplin.)

(The question referred to was read by the reporter, as set forth above.)

The Witness: Well, Miss Mary Pickford I think in the eyes of the motion picture people was the First Lady of filmland. She was the most important female star. I think, in the motion picture business at that time. [159]

Q. (By Mr. Wright) Will you tell us, Mr. Chaplin, the standing of Mr. Fairbanks as an actor and producer of photoplays at that time?

A. I would say he also was the First Gentleman of the motion picture industry, and a very important star in the industry.

Q. Will you also tell us the standing of Mr. D. W. Griffith of the producers and directors?

A. Undoubtedly he was recognized as the greatest director at that time.

Q. All four of you were constantly in demand by other companies, were you not, at this time?

A. Yes.

Q. At this time you received numerous propositions from other corporations, did you not?

A. Yes.

Q. To produce photoplays for distribution through other companies?

A. Yes, several.

Q. Would you consider, Mr. Chaplin, that because of the unusual and outstanding abilities and favor with the public of Miss Pickford, Mr. Fairbanks and Mr. Griffith, as well as yourself, the

(Testimony of Charles Spencer Chaplin.)

execution of the agreement of February 5, 1919, and the agreement to subscribe to preferred stock of United Artists Corporation and the execution of the [160] respective distribution contracts was a fair consideration for the issuance of common stock? A. Yes.

Mr. Horner: Just a moment, please. If your Honor please, I don't like to be too insistent, but that is a very leading question, and it seems to me it is objectionable from every standpoint. I don't know whether Mr. Wright is testifying or whether Mr. Chaplin is testifying.

The Court: Yes. The questions are quite leading. When we get into controversial matters, it is perhaps as well to not lead the witness. I will sustain the objection to the particular question.

Mr. Wright: Might I be heard on that, if your Honor please?

The Court: You may.

Mr. Wright: Mr. Chaplin was an organizer of United Artists Corporation. He has testified he has had 27 years experience in the motion picture industry. I think he is competent by reason of those two things alone to testify as to value, as to adequacy of consideration for the issuance of the common stock. It is on that theory that we offered the question.

The Court: You may desire to reframe the question.

Mr. Wright: I will reframe it. I wanted to save time, if I could. [161]

(Testimony of Charles Spencer Chaplin.)

Q. Mr. Chaplin, you have testified that Miss Pickford, Mr. Fairbanks, and Mr. Griffith each had unusual worth in the motion picture business in 1919, is that correct? A. Yes.

Q. Because of that unusual worth, in your opinion would any goodwill result to United Artists Corporation by reason of their contracting with United Artists Corporation?

A. Yes. I could give you an example of that.

In the beginning of the idea of the forming of United Artists, Douglas Fairbanks, Mary Pickford, they had difficulty in getting a new contract from their companies, and the company that I was working for, the First National, were also very indifferent about my plea for certain concessions that I wanted them to make for the purpose of making my pictures. And we felt there was something in the air. And we had heard that there was to be a convention of the First National, the Metro. and the Goldwyn Company, and they were coming out to form a combine and to sign up the exhibitors throughout America on a six year contract. And having, of course, Mary Pickford under contract, and having Douglas Fairbanks under contract, and the First National at that time having me under contract for four pictures, or something like that to go, they were going to sign these exhibitors up.

[162]

And we heard about this, and to offset that—it was supposed to be a \$40,000,000 trust corporation which they were all going to merge for the purpose,

(Testimony of Charles Spencer Chaplin.)

because they had these stars in hand,—and I think it was my brother, and also several other associates of Mary and Douglas that got the idea and said, “Well, if we made a gesture and merely, just a letter in which we said at some future date we would merge and from our own distributing company, it would stop this big corporation, this big trust, from combining.”

And we had no intention—first, we had no intention at first of really going through with it. All we felt was that if we just put our names together, that that in itself would insure the exhibitors that they hadn’t got all of the stars under contract and that this big combine had nothing to do with the then important stars of the industry.

So we met at the Hotel Alexandria, which was at that time the place where all the motion picture people congregated, and we were there on the million dollar rug, as they called it in those days, and we just made a gesture. This convention used to meet at dinner, and so we had a little convention of our own, and we sat at a table and we started making figures on the tablecloth and impressing, and suddenly each one of these that belonged to the other corporations would come into the dining room and they [163] could see Mary Pickford, Douglas Fairbanks, D. W. Griffith, William S. Hart and myself making figures on the tablecloth. And it made a great impression.

Then we gave out an announcement. I think the captain referred to it as the declaration of inde-

(Testimony of Charles Spencer Chaplin.)

pendence. I don't remember the exact wording, but I do know that the next day they all folded up and went back and there was no more \$40,000,000 corporation. And after that we said, "This is a grand idea. Why not go through with this idea and let us really form a corporation. Let us really go through with it." And we did.

So it was absolutely the goodwill and the influence we had and our names put together that was of great value. It absolutely disintegrated the trust at that time.

Q. I will show you a receipt, Mr. Chaplin, marked Exhibit 12.

As the Petitioner's Exhibit No. 12, Mr. White, are these key numbers correct numbers?

Mr. Green: No. Those numbers should come off, Mr. Wright.

Mr. Horner: What document do you have, Mr. Wright?

Mr. Wright: Dated December 11, 1919.

Pardon me. I am sorry. I thought they were introduced when all of them went in.

Q. Mr. Chaplin, is that your signature? [164]

A. Yes.

Mr. Wright: Have you seen a copy, Mr. Horner?

Mr. Horner: I have not.

Mr. Wright: We would like to introduce a copy of that as the next exhibit.

May we introduce it, if your Honor please, and withdraw it and substitute conformed copies?

(Testimony of Charles Spencer Chaplin.)

The Court: Very well. No objection.

Mr. Horner: No objection.

The Court: It will be received as Petitioner's Exhibit No. 56.

(The said document, so offered and received in evidence, was marked Petitioner's Exhibit 56, and made a part of this record.)

PETITIONER'S EXHIBIT No. 56

Received from Dennis F. O'Brien, Depositary, the certificate of deposit delivered to me as attorney for Charles Chaplin, evidencing deposit with Mr. O'Brien of nine stock certificates representing in the aggregate, one thousand shares of common stock of the United Artists Corporation, pursuant to a certain agreement dated August 5th, 1919.

Dated, New York, September 11th, 1919.

CHARLES CHAPLIN.

[Endorsed]: U.S.B.T.A. Filed Feb. 26, 1941.

The Court: Will you identify it briefly for the record as to what it is?

Mr. Wright: Yes. That is the receipt for the delivery to Mr. Chaplin. Perhaps I could read it into the record.

“Received from Dennis F. O'Brien, deposi-

(Testimony of Charles Spencer Chaplin.)

tary, certificate of deposit delivered to me as attorney for Charles Chaplin evidencing deposit with Mr. O'Brien of nine stock certificates representing in the aggregate 1,000 shares of common stock of United Artists Corporation pursuant to a written agreement dated August 5, 1919. Dated, New York, [165] September 11, 1919. Charles Chaplin."

Q. Mr. Chaplin, I show you a memorandum agreement dated June 1, 1932, addressed to Mr. Joseph M. Schenck as well as United Artists Corporation, executed by United Artists Corporation, Mary Pickford Fairbanks, Douglas Fairbanks, Charles Chaplin, David W. Griffith, and D. W. Griffith, Inc. and ask you to examine that and state whether or not you signed the original of that conformed copy.

A. (Examining document.) Yes.

Q. Referring to the first page of this agreement, Mr. Chaplin—you answered that question that you had signed the contract, did you not?

A. I had signed the original.

Q. This agreement recites the following, Mr. Chaplin:

"That at the time of the execution of the aforesaid agreement all of the preferred and common stock of United Artists Corporation then outstanding was owned by Mary Pickford Fairbanks, Douglas Fairbanks, Charles Chaplin, David W. Griffith, and D. W. Griffith, Inc.

(Testimony of Charles Spencer Chaplin.)

subject to certain then existing escrow agreements pertaining to the common stock.”

Was that a fact?

A. Yes. My mind was——

Mr. Wright: Mr. Reporter, will you read the question, please? [166]

(The question referred to was read by the reporter, as set forth above.)

The Witness: Yes.

Q. (By Mr. Wright) Mr. Chaplin, I show you a letter dated October 29, 1919, the United Artists Corporation. A. Yes.

Q. And ask you if you received that letter.

A. (Examining document) I suppose so. I am not definite, because, as I say, I had my office and everybody to know those things. I don't know whether I personally received it, but I think it was notified to me. I was notified of the fact, I am sure. It is going back a long time.

Mr. Wright: Yes, that is true.

Will you stipulate, Mr. Horner, that this letter of October 27, 1919, the United Artists Corporation to Mr. Chaplin, has attached to it a balance sheet, consolidated balance sheet?

Mr. Horner: May I look at it a moment?

(Examining document.) I will stipulate, Mr. Wright, that the letter you refer to did have attached to it a copy of a paper called “The Consolidated Balance Sheet.” As to whether those figures are accurate or inaccurate, of course I am

(Testimony of Charles Spencer Chaplin.)

not prepared to say, and I don't want to stipulate to that effect. I have had no opportunity to check them, if that will help you any. [167]

Mr. Green: Mr. Horner, this balance sheet is being offered for the purpose of showing—in the assets it has an item “Artists’ contracts, \$25,000 and capital stock common, \$25,000”—it is offered for the purpose of showing that the corporation set upon its books a value of \$25,000 for the four artists’ contracts that were signed on February 5, 1919, and on its liability side, \$25,000 is the value of that common stock. The balance sheet is offered for that purpose and no other purpose.

Mr. Horner: For that limited purpose, then, I have no objection.

Mr. Wright: Would you rather stipulate to that fact, or would you rather introduce the copy of the consolidated sheet in evidence?

Mr. Horner: I think it would be preferred to just stipulate the figures Mr. Green read and keep out of the record the immaterial part of this exhibit.

Mr. Wright: Very well. Then it will be stipulated that the facts as recited by Mr. Green were the situation at the close of business September 27, 1919?

Mr. Horner: That is right.

Q. (By Mr. Wright) Mr. Chaplin, you have at all times treated the common stock and all of the common stock of United Artists Corporation as you

(Testimony of Charles Spencer Chaplin.)

have all other common stock which you have owned, have you not? [168]

Mr. Horner: Just a moment. That seems to be highly leading and objectionable, your Honor.

The Court: Well, perhaps counsel may reframe it and get the information desired. I suppose you mean by that as to what he has done with reference to voting it and attending directors' meetings and so on.

Mr. Wright: Yes, sir.

The Court: Suppose you reframe it, if you will.

Q. (By Mr. Wright) Mr. Chaplin, since September, 1919 at all stockholders' meetings of United Artists Corporation you have by person or by proxy voted 1,000 shares of common stock, have you not?

A. Yes.

Q. Since September, 1919 you have received all reports of the corporation as a stockholder?

Mr. Horner: Pardon me. I lost the context of the question. Will you read the question, Mr. Reporter?

(The question referred to was read by the reporter, as set forth above.)

The Witness: Yes.

Q. (By Mr. Wright) Other than the depositing the stock with Captain O'Brien—pardon me. I must apologize to the Court. I have known him as Captain. It is difficult to call him Dennis—Mr. Chaplin, you have exerted the same control over the United Artists common stock as you [169] have

(Testimony of Charles Spencer Chaplin.)

over any other stock that you have owned in the corporation, have you not? A. I have.

Mr. Wright: That is all.

Mr. Horner: If you Honor will indulge me for about five minutes, I think possibly I can reach a very quick decision as to the extent of any examination.

The Court: Very well. We will suspend for a brief recess.

(At this point a short recess was taken, after which proceedings were resumed, as follows:)

Mr. Horner: No cross examination, your Honor.

The Court: Very well.

Mr. Green: That is all.

(Witness excused.)

Mr. Green: That is the Petitioner's case, your Honor.

Mr. Horner: The Respondent rests, your Honor.

The Court: That concludes the hearing of the testimony then, on both sides?

Mr. Horner: Yes.

[Endorsed]: U.S.B.T.A. Filed Mar. 14, 1941.[170]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B.T.A. No. 98795

CHARLES CHAPLIN,

Petitioner on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

GUY T. HELVERING, Commissioner of Internal
Revenue,

Petitioner on Review,

v.

CHARLES CHAPLIN,

Respondent on Review.

ORDER

Now on consideration of the joint motion filed herein by counsel for the respective parties to the above-entitled proceedings, it is

Ordered, that the above-entitled proceedings be and they are hereby consolidated for briefing, hearing, argument and decision upon a single consolidated transcript of record to be certified and transmitted to this Court by the Clerk of the United States Board of Tax Appeals, and that the costs of printing the consolidated record on review be borne 75 per centum by the taxpayer and 25 per centum by the Commissioner.

It is further ordered that the Clerk of this Court

transmit to the Clerk of the United States Board of Tax Appeals a certified copy of this order to be by him incorporated in the record on review as certified and transmitted by him to the Court.

Done at San Francisco, California, this 1 day of Aug. A.D., 1942.

FRANCIS A. GARRECHT

Judge, United States Circuit
Court of Appeals.

[Endorsed]: Filed Aug. 1, 1942.

A true copy

Attest: Aug. 1, 1942

(Seal) (S) PAUL P. O'BRIEN,
Clerk.

[Endorsed]: U.S.B.T.A. Filed Aug. 6, 1942. [333]

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS

Comes Now the petitioner on review herein and makes this concise Statement of Points on which he intends to rely on the review herein, to-wit:

The United States Board of Tax Appeals erred:

1. In holding that the sum of \$44,532.22, which was received by taxpayer in 1935 from the escrow agent, and which was attributable to the accumulated dividends which the escrow agent had received in prior years on escrow stock which was also re-

leased to the taxpayer in 1935, was "received as dividends from a domestic corporation which is subject to taxation" under Title I of the Revenue Act of 1934 and hence the credit for normal tax, as specified in section 25(a) of such act, should be allowed; and in overruling the Commissioner's determination that this sum constituted ordinary income and was subject to the normal tax.

2. In holding that there is a deficiency in income tax for the year 1935 in the amount of only \$63,427.19. [334]

3. In failing to hold that there is a deficiency in income tax for the year 1935 in the amount of \$65,208.48.

4. In holding that said sum of \$44,532.22 did not lose its character as dividends merely because it was not delivered to taxpayer in the year declared.

5. In holding that "but if respondent's view be accepted that the amounts set aside in each year were not true dividends, then it would seem that the action of the corporation in the taxable year, making them unconditionally available to petitioner, was tantamount to the declaration and payment by the corporation of a dividend in the aggregate amount of \$44,532.22 upon the 334 shares which petitioner had just received."

6. In failing to hold that the sum of \$44,532.22 received by taxpayer from the escrow agent in 1935 was not received by him as dividends and is not the subject of normal tax credit.

7. In that its opinion and decision are contrary to law.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Service of a copy of the above statement of points is hereby acknowledged this 31st day of July, 1942.

(Sgd) LOYD WRIGHT

Attorneys for Respondent on
Review.

JMM:mgc-6-10-42

[Endorsed]: U.S.B.T.A. Filed Aug. 5, 1942. [335]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PORTIONS OF THE
RECORD TO BE PRINTED

Come Now the parties to the above-entitled causes, by their respective counsel of record, and complying with the rules of this Court, pertaining to the designation of the portions of the record to be printed, state that they rely upon the entire record certified by the Clerk of the Board of Tax Appeals to this Court, and direct that said record so certified be printed as the record on review.

Respectfully submitted,

LOYD WRIGHT,

Attorneys for Taxpayer.

J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Attorney for Commissioner of
Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed Aug. 5, 1942. [336]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PORTIONS OF RECORD,
PROCEEDINGS, AND EVIDENCE TO BE
CONTAINED IN RECORD ON REVIEW.

To the Clerk of the United States Board of Tax
Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings:
 - (a) Petition.
 - (b) Answer.
 - (c) Amended Answer.
3. Board's findings of fact, opinion and decision.
4. Petitions for review.
5. Notices of filing petitions for review. [337]
6. Agreed Stipulation of Facts.
7. Transcript of hearing February 26, 1941, before U. S. Board of Tax Appeals at Los Angeles, California, pages 1 to and including line 21, page 122, but excluding pages 2, 2A, 2B, and the opening statements from line 8, page 8, to and including line 6, page 17.
8. Petitioner's Exhibits 1 to 56, inclusive.

9. Court order for consolidation.
10. Statement of points.
11. Designation of portions of the record to be printed.
12. This designation.

LOYD WRIGHT,

Attorneys for Taxpayer.

(Signed) J. P. WENCHEL,

RLW

Chief Counsel,

Bureau of Internal Revenue.

Attorney for Commissioner of
Internal Revenue.

JMM:MGC-7-15-42

[Endorsed]: U.S.B.T.A. Filed Aug. 5, 1942. [338]

United States Board of Tax Appeals
Washington

Docket No. 98795

CHARLES CHAPLIN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

CHARLES CHAPLIN,

Respondent.

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 338, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 4th day of September, 1942.

[Seal]

B. O. GAMBLE,

Clerk, United States Board of
Tax Appeals.

[Endorsed]: No. 10245. United States Circuit Court of Appeals for the Ninth Circuit. Charles Chaplin, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Commissioner of Internal Revenue, Petitioner, vs. Charles Chaplin, Respondent. Transcript of the Record. Upon Petitions to Review a Decision of the United States Board of Tax Appeals.

Filed September 12, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 10245

BTA 98795

CHARLES CHAPLIN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS

Come now Charles Chaplin, petitioner herein, and adopts as his statement of points each and all of the assignments of error set forth in his petition for

a review of the decision of the United States Board of Tax Appeals, which constitutes a part of the record in the above entitled matter.

Respectfully submitted,

LOYD WRIGHT

CHARLES E. MILLIKAN

HERSCHEL B. GREEN

Counsel for Petitioner.

Copy mailed to J. P. Wenchel, Chief Counsel for Bureau of Internal Revenue on September 16, 1942.

[Endorsed]: Filed Sep. 18, 1942.

No. 10245.

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

CHARLES CHAPLIN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

CHARLES CHAPLIN,

Respondent.

**BRIEF FOR PETITIONER,
CHARLES CHAPLIN.**

UPON PETITIONS TO REVIEW A DECISION OF THE TAX
COURT OF THE UNITED STATES.

LOYD WRIGHT,

CHARLES E. MILLIKAN,

HERSCHEL B. GREEN,

111 West Seventh Street, Los Angeles,
Attorneys for Petitioner, Charles Chaplin.

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Petitioner,

vs.

CHARLES CHAPLIN,

Respondent.

BRIEF FOR PETITIONER,
CHARLES CHAPLIN.

Petitioner instituted proceedings before the Tax Court pursuant to Internal Revenue Code, Sections 272 (a) (1) and 1101, for the redetermination of a deficiency in his income tax asserted by the respondent for the calendar year 1935. His petition alleged errors which were denied in the respondent's answer thereto. The Tax Court's decision holding that there was a deficiency in income tax for the year 1935 was promulgated on the 24th day of February, 1942, and entered on the 6th day of April, 1942.

These proceedings are brought to this court by petition for review filed with the Clerk of said Tax Court on June 8, 1942 [R. 47-54], pursuant to the provisions of Internal Revenue Code sections 1141 and 1142. A copy of said petition for review, with notice of the filing thereof, was served upon the respondent on June 8, 1942. [R. 56.]

Statement of the Case.

On February 5, 1919, petitioner, Douglas Fairbanks, and Mary Pickford, artists, and David W. Griffith, producer, entered into an agreement to associate themselves together in the distribution of motion pictures thereafter produced by them. [Exhibit 1, R. 73.] All of the parties were favorably known in all parts of the world where motion pictures were exploited and exhibited and their respective names had exceptional trade value. [R. 74.] The agreement provided, among other things, that they would organize a corporation to be known as the United Artists Corporation (hereinafter sometimes referred to as the corporation), with two classes of stock, class A—6000 shares of 8 per cent cumulative preferred stock, par value \$100 per share, and class B—9000 shares of common stock, no par value. Each of the parties was to purchase 1,000 shares of the preferred stock at \$100 per share, it being contemplated that this stock would be redeemed by the corporation. [R. 75-76-78.] The common stock was to be issued and paid for in the following manner [R. 76]:

“One thousand (1000) shares to each of the above named persons in part consideration of the execution and fulfillment of the contract pertaining to the exploiting, marketing, distributing and turning to account of his or her motion pictures with the said cor-

poration. The details concerning the delivery of the aforesaid common shares of stock to each of the aforesaid persons shall be more fully set forth in the agreement between said person and said corporation pertaining to the exploiting, marketing, distributing and turning to account the motion pictures produced by such person and included in such contract.

One thousand (1000) shares to William G. McAdoo who is to become the General Counsel of said corporation.”

All of the common stock was to be issued “subject to the right of the corporation for its then existing stockholders to repurchase the same in the event of such stockholder desiring to sell any portion or all of his or her shares of common stock in said corporation to any person who is not actively associated with such stockholder in the business of producing photoplays.” [R. 77.] The substance of this provision was included in the by-laws subsequently adopted by the corporation. [Exhibit 3, R. 105-6.]

On April 17, 1919, the certificate of incorporation of United Artists Corporation was filed with the Secretary of State of Delaware. [R. 67.] It authorized the issuance of 5000 shares of preferred stock, \$100 par value, and 9000 shares of common stock. The preferred stock was to have no voting rights. Each holder of shares of common stock was entitled to as many votes at all elections of directors as his number of shares multiplied by the number of directors to be elected. [Exhibit 2, R. 85.]

On February 5, 1919, petitioner signed a proposed distribution agreement which was subsequently executed by the corporation on June 13, 1919. [Exhibit 5, R. 114.]

Similar agreements were signed by Douglas Fairbanks, Mary Pickford and D. W. Griffith. The agreement signed by petitioner provided, among other things, that he would produce and deliver to the corporation nine photoplays of between 1600 and 3000 feet in length within three years from the date thereof. [R. 117.] The corporation obligated itself to give petitioner's name "chief prominence" in the advertisements of his pictures [R. 120], to use its best efforts to market the films upon a basis of sharing in gross receipts, and agreed that no franchise or territorial right for the use of such photoplays should be made without his written consent. [R. 123.] Subdivision (i) of the "Third" paragraph of this agreement reads as follows:

"(i) And in addition to the above consideration, one thousand (1000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation nine (9) photoplays. Should said artist be unable to deliver nine (9) such photoplays because of illness or incapacity during the said entire period of three (3) years, said artist shall receive so many of the aforesaid one thousand (1000) shares of the common stock of this corporation as the number of photoplays delivered by said artist to this corporation pursuant to this agreement bears to the number of nine. The balance of the shares of such common stock shall be delivered by such escrow agent to this corporation." [R. 124-125.]

At a special meeting of the board of directors of United Artists Corporation held on May 29, 1919, the following resolutions were adopted:

“Whereas in the judgment of the Board of Directors the photoplays agreed to be delivered to this Corporation under said contracts are necessary for the business of this Corporation and constitute good and sufficient consideration for the issue of five thousand (5000) shares of the common stock of this Corporation, the same being without par or nominal value:

Resolved, that in consideration of the delivery of said contracts to this Corporation the proper officers of this Corporation be, and they hereby are, authorized to issue and deliver to William G. McAdoo, Esq., one thousand (1000) shares of no par value of this corporation fully paid and non-assessable, said shares to include the shares of no par value subscribed for by the signers of the certificate of incorporation of this Corporation, assignments of said subscriptions being held by him; and

Resolved that in consideration of the delivery of said contracts of this Corporation, the proper officers of this Corporation be, and they hereby are authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) one thousand (1000) shares of no par value each, making a total of four thousand (4000) shares of no par value to a person or corporation to be agreed upon by said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known

as Mary Pickford) and this Corporation, and to no other person, said four thousand (4000) shares to be held by said person or corporation in escrow in accordance with the provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation; and

Resolved that the proper officers of this Corporation be, and they hereby are, authorized and directed to execute an escrow agreement for the holding and delivery of said four thousand (4000) shares of non-par value in accordance with the terms and provisions of said contracts between Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation dated February 5th, 1919, said escrow agreement to provide that while said four thousand (4000) shares are held in escrow, each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this corporation before execution of the same by its officers." [Exhibit 18, R. 231-4.]

On June 9, 1919, the corporation issued 9 certificates of stock—8 for 111 shares each and one for 112 shares—in which petitioner was shown as the owner. [R. 67.] The certificates were not delivered to petitioner, but were kept in the possession of the corporation until subsequently delivered to and deposited with the escrow agent in accordance with the agreement between petitioner and his associates and with the corporation.

The following entry appears in the journal of United Artists Corporation:

“June 9 (1919) Artists’ Con-
tractsA-4 \$25,000.00
Consideration for contracts
with the four artists for delivery
of photoplays to Corporation as
per resolution of Board of Di-
rectors adopted May 29, 1919
(ratified by stockholders Sept.
9, 1919)
Capital Stock—commonC-7 \$25,000
Issued 5000 shares at no par
value, but regarded to have a
value of \$5.00 per share
(verbal advice of General
Counsel)” [Exhibit 14, R.
205.]

On July 5, 1919, the petitioner, Douglas Fairbanks, Mary Pickford and D. W. Griffith entered into an agreement with the United Artists Corporation amending subdivision (i) of paragraph 3 of their respective agreements of February 5, 1919, as follows:

“And in addition to the above consideration, one thousand (1000) shares of the common stock of the said corporation to be issued in the name of the said Artist in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each and one of which shall be for one hundred and twelve (112) shares, said certificates to be

delivered in escrow to a person or corporation to be agreed upon by the parties hereto. Upon delivery by the said Artist to the said corporation of each one (1) of the first eight (8) photoplays called for by this contract, such escrow agent shall deliver to the said Artist one (1) of said certificates for one hundred and eleven (111) shares, and upon delivery by the said Artist to the said corporation of the ninth (9th) photoplay called for hereunder, such escrow agent shall deliver to the said Artist said certificate for one hundred and twelve (112) shares. Upon the expiration of the three-year period herein provided for, so many of said certificates as are then still held by such escrow agent in accordance with the provisions of this paragraph shall be delivered by such escrow agent to the said corporation." [Exhibit 6, R. 140-1.]

On August 5, 1919, the petitioner, the United Artists Corporation, and one Dennis F. O'Brien, as escrow agent, entered into an agreement providing *inter alia* as follows:

"First: The Corporation shall forthwith deliver to, and deposit with, the Depositary the nine (9) stock certificates, representing in the aggregate one thousand (1000) shares of the common stock of the Corporation, which have been issued in the name of the Artist as aforesaid.

Second: Upon receipt of said stock certificates, the Depositary shall issue in respect thereof in the name of the Artist a certificate of deposit * * *

Third: Upon delivery by the Artist to the Corporation of each one (1) of the first eight (8) photoplays called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to one (1) of said certificates

for one hundred and eleven (111) shares, whereupon the Depositary shall deliver one (1) of the same to the Artist upon surrender by the latter of the certificate of deposit herein provided for and shall issue to the Artist a new certificate of deposit, substantially in the form of that annexed hereto, in respect of the number of shares remaining in escrow. Upon delivery by the Artist to the Corporation of the ninth (9th) photoplay called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to said certificate for one hundred and twelve (112) shares, whereupon the Depositary shall deliver the same to the Artist upon surrender by the latter of the certificate of deposit which he then holds. At the expiration of said period of three years, the Depositary shall deliver to the Corporation so many of the certificates deposited hereunder as then remain in escrow and are not the property of the Artist, and the Artist shall return to the Depositary the certificate of deposit which he then holds.

Fourth: Any and all dividends which may be declared upon the shares of stock represented by the Certificates deposited hereunder while the same, or any part thereof, are held in escrow by the Depositary shall be deposited by the Corporation in the Central Union Trust Company, No. 80 Broadway, New York City, in an account to be known as 'United Artists Corporation, Trust Account No. 1.' Upon delivery to the Artist by the Depositary, in the manner hereinbefore provided for, of each of the certificates deposited hereunder, the Corporation shall pay to the Artist one-ninth ($1/9$) of all dividends which at the time of such delivery shall have been deposited in said account, together with accrued interest thereon. At the expiration of said period of three years, so much of

such dividends and interest thereon as remain in said account and are not due the Artist shall become the property of the Corporation.

Fifth: The Depositary shall not have the right to vote the shares of stock deposited hereunder.

* * * * *

Seventh: This agreement shall be binding upon the heirs, legal representatives, successors and assigns of the parties hereto." [Exhibit 7, R. 143-7.]

The form of the certificate of deposit was as follows:

"Certificate of Deposit

No.	Certificate of Deposit	No. of Shares
representing the Common Stock of United Artists Corporation.		

This Is to Certify that there have been deposited with Dennis F. O'Brien (herein called the 'Depositary'), under a written agreement, dated....., 1919, (a copy of which is on file at the office of Depositary), for the benefit of Charles Chaplin (herein called the 'Beneficiary'), nine (9) stock certificates representing in the aggregate one thousand (1000) shares of common stock of United Artists Corporation, without par value, and that under said agreement the Beneficiary will be entitled to a delivery of said stock certificates or some portion thereof upon surrender hereof and upon receipt by the Depositary of a written notice from United Artists Corporation that the Beneficiary is entitled thereto under the terms of said agreement.

The holder of this certificate of deposit shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation." [Exhibit 12, R. 194.]

Petitioner did not deliver any motion pictures to the corporation during the three-year period contemplated in the agreement of February 5, 1919 [R. 209, 216], nor was any modification of the agreement made during the three-year period extending the time in which the nine motion pictures should be delivered. [R. 217.] Upon the expiration of the three-year period none of the 1000 shares of stock held in escrow under the contract with petitioner was delivered back to the corporation [R. 217], nor was any demand made upon the escrow agent by the corporation, or any of its officers, directors, or stockholders that such shares of stock be returned to the corporation. [R. 217.] At the end of the three-year period none of the parties to the agreements had delivered all of the nine pictures required by their contracts to the corporation; but the depositary did not turn back to the corporation any of the stock standing in their names and held by him in escrow. [R. 217.]

In 1923 petitioner delivered to the corporation one photoplay, "Woman of Paris," which was released November 4 of that year. At that time the escrow agent turned over to him one certificate for 111 shares of stock. This left eight pictures undelivered by petitioner under his contract and eight certificates of stock still held by the escrow agent. [R. 196-198.]

On November 22, 1924, the petitioner, Mary Pickford, Douglas Fairbanks, Joseph Schenck and United Artists Corporation entered into an agreement further modifying the distribution agreement of February 5, 1919. [Exhibit 8, R. 148.] As modified, it recites that "Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all of the preferred and common stock of the corporation, now issued and outstanding" except certain qualifying shares,

and provides, among other things, that in addition to the nine pictures originally contracted for, Pickford will produce six feature photoplays and Fairbanks will produce five, all to be delivered by November 1, 1928; but neither "shall receive any additional common stock" beyond the amounts provided to be delivered to them during the term of their original contract. The agreement also provides that petitioner will produce five pictures to be delivered one each year, all to be delivered on or before January 1, 1929, instead of the eight undelivered pictures provided for in the original contract, and "The balance of the common stock of the corporation, which is now held in escrow for the benefit of Chaplin, shall be delivered to him in the proportion of one-fifth ($1/5$) thereof upon the delivery of each motion picture photoplay by Chaplin to the corporation."

Thereafter petitioner produced and delivered to United Artists Corporation three pictures which were released on the following dates: "The Gold Rush"—August 16, 1925; "The Circus"—January 7, 1928; and "City Lights"—March 1, 1931. [Exhibit 15, R. 211.]

On October 31, 1928, petitioner delivered to the corporation the certificate for 111 shares of its common stock which had been released from escrow upon the delivery of the photoplay, "Woman of Paris," and at said time the 889 shares still held in escrow by Dennis F. O'Brien were delivered to the corporation. All of the certificates of stock were forthwith cancelled, and on the same date the corporation issued in the name of petitioner the following certificates of common stock: No. 83 for 166 shares; No. 84 for 167 shares; No. 85 for 166 shares; No. 86 for 167 shares; No. 87 for 167 shares; and No. 88 for 167 shares, a total of 1000 shares. [R. 197.] All of the foregoing

certificates were placed in escrow with Dennis F. O'Brien pursuant to the agreement dated February 5, 1919, as amended. Thereafter on November 8, 1928, there were released from escrow and delivered to petitioner certificates No. 83 for 166 shares; No. 84 for 167 shares, and No. 85 for 166 shares of the common stock of the corporation.

On February 27, 1931, certificate No. 86 for 167 shares was released from escrow and delivered to petitioner upon completion of the picture "City Lights."

All of the pictures delivered by petitioner to the corporation were much longer than the 1600 to 3000 feet specified in the agreement. [R. 316.]

On September 20, 1935, an agreement was entered into between petitioner and the corporation under which certificates Nos. 87 and 88 for 167 shares each were released to petitioner, together with accumulated dividends thereon in the sum of \$44,532.22, which had been paid to the escrow agent in the following years:

1930	\$ 6,680.00
1931	3,340.00
1932	3,340.00
1934	31,172.22

Total	\$44,532.22
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[Exhibit 10, R. 169.]

No pictures were ever delivered by petitioner which would entitle him to the release from escrow of certificates Nos. 87 and 88 for 167 shares each.

The dividends had been deposited in a special bank account and interest on such deposits in the amount of

\$995 was paid to the petitioner when the stock and dividends were released. [R. 212, 306.] This amount was included in gross income in petitioner's income tax return for 1935.

The 1000 shares of common stock issued to William Gibbs McAdoo were surrendered to the corporation in 1920. Subsequently in 1924, 1000 shares were issued to Joseph M. Schenck. The stock referred to in this paragraph was never put in escrow.

When the original 9 certificates totaling 1000 shares of stock were put in escrow, petitioner did not sign them. [R. 191.] When these certificates were cancelled by the corporation and 6 certificates totalling 1000 shares were issued in their stead and placed in escrow, petitioner signed these 6 certificates in blank. [Exhibit 9, R. 166.]

After the organization of the corporation, petitioner attended stockholders' meetings, voted at such meetings for directors and otherwise, received notices, and signed proxies the same as any stockholder. [R. 220-1.] He was carried on the books of the corporation as the owner of 1000 shares of common stock. [R. 201, 252, 260-261.] Petitioner in many instances was referred to in the minutes of the corporation as the "owner of 1000 shares." [Exhibits 43, R. 265; 44, R. 267; 45, R. 269; 48, R. 272; 49, R. 275; 50, R. 250; 51, R. 279; 52, R. 281.] The dividends upon the stock standing in his name were deposited in a trust account in a New York bank in accordance with the escrow agreement. [R. 212.]

In computing the deficiency here in issue the respondent determined the fair market value of the 334 shares of common stock of the United Artists Corporation, delivered to petitioner from escrow in 1935, to be \$104,709

and added this amount to petitioner's income for that year.

In his income tax returns for 1935 petitioner treated the \$44,532.22 as dividends received in that year and not subject to the normal tax. The respondent determined that the \$44,532.22 did not represent "dividends" received in the taxable year and the amount was treated as ordinary income in determining the deficiency in tax. Petitioner filed with the respondent a claim for refund of \$24,938.04 representing the tax paid on the \$44,532.22 dividends.

In said claim petitioner contended that the tax should have been paid on said dividends in the year in which the same were received and not when released from escrow some years later.

Specification of Errors.

Petitioner relies on all of the points contained in his statement heretofore filed [R. 51-53, 342, 343], to wit:

The Tax Court erred:

1. In holding that there is a deficiency of \$63,427.19 in petitioner's income tax for the year 1935.
2. In holding that petitioner became the owner of 334 shares of common stock of United Artists Corporation in 1935 when said stock was released from escrow and delivered to petitioner.
3. In failing to hold that petitioner became the owner of the 334 shares of common stock when issued to petitioner in 1919.
4. In failing to hold that said one thousand shares of common stock issued to petitioner in 1919 constituted a consideration for the execution by the petitioner of the distribution agreement.

5. In failing to hold that the shares of common stock were held by the escrow agent as security for the performance by petitioner of his contract to deliver pictures.

6. In failing to hold that it was the intention of all parties to the original contract that petitioner should become the owner of said shares of common stock when issued in 1919.

7. In failing to hold that the dividends declared and paid on said common stock when held in escrow constituted income to petitioner in the years in which said dividends were paid.

8. In holding that said dividends constituted taxable income to petitioner in 1935.

9. In holding that the fair market value of the 334 shares of common stock, namely, \$104,709.00, constituted taxable income to petitioner in 1935.

10. In holding that petitioner derived income from the release from escrow and delivery to petitioner of the 334 shares of common stock in 1935.

11. In that its decision was not supported by the evidence and is contrary to law.

12. In rendering decision for the respondent and against petitioner.

Summary of Argument.

In support of his appeal, petitioner respectfully submits that the evidence shows without contradiction that petitioner became the owner of 1000 shares of common stock of United Artists Corporation on June 9, 1919, and thereafter continued without interruption as the owner of said 1000 shares of said stock. The 334 shares of said stock in connection with which the tax involved in this proceeding has been assessed were a part of said original issue of 1000 shares.

Our argument in support of the proposition above stated will be subdivided, and appropriate references to the record will be made under each subdivision. These subdivisions are as follows:

(a) Said stock was issued to petitioner June 9, 1919, and ever since he has exercised all incidents of ownership thereof, including voting said stock and all thereof at all of the meetings of the corporation held since said date.

(b) Dividends were declared on said 1000 shares of stock while held by the depositary and placed in trust for petitioner's benefit.

(c) The corporation at all times considered and treated petitioner as the owner of said stock after its issuance on June 9, 1919 in all corporate affairs.

(d) The consideration for the issuance of said 1000 shares of stock was the execution by petitioner of the distribution agreement of February 5, 1919.

(e) Said 1000 shares of stock were placed with a depositary as security for the performance by petitioner of a distribution agreement entered into between United Artists Corporation and petitioner on February 5, 1919.

(f) The dividends declared on said shares of stock while in the possession of the depository were impounded to encourage compliance by each artist with his distribution contract.

(g) The terms of petitioner's contract, so far as the same related to the number of photoplays required to be delivered and the time of delivery, were abandoned both by United Artists Corporation and by petitioner.

Argument.

The Tax Court's decision presents a reviewable question. The power of this court to review and dispose of decisions of the Tax Court is derived under I. R. C., Section 1141. Subdivision (c) (1) of said section provides:

"To Affirm, Modify or Reverse.—Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require."

The key to the Tax Court's decision is set forth in its opinion wherein it is stated:

"The terms and conditions of the agreements briefly referred to above and the action of the parties under them indicate, in our judgment, it was the intention of the parties that ownership of the stock should not pass to petitioner until and unless he 'fulfilled' the terms and conditions of his contract and delivered to the corporation the photoplays stipulated therein. [R. 38.]

"In either event, we are of the opinion that the amount (\$44,532.22 in dividends) was 'received as

dividends from a domestic corporation, which is subject to taxation' under Title I of the Revenue Act of 1934 and hence the credit for normal tax as specified in Section 25 (a) of such Act should be allowed." [R. 44.]

Thus there is presented a conclusion of law or at least a determination of a mixed question of law and fact. Whether such holding of the Tax Court be viewed as a conclusion of law or as a determination of a mixed question of law and fact is immaterial since in either event it is subject to judicial review wherein this court may substitute its judgment for that of the Tax Court.

Helvering v. Tex. Penn Oil Co., 300 U. S. 481. 491;

Bogardus v. Commissioner, 302 U. S. 34, 39;

Union Trust Co. of Butler v. Commissioner, 84 Fed. (2d) 386;

Commissioner v. Southern Bell T. & T. Co. (C. C. A. 6), 102 Fed. (2d) 397;

Commissioner v. Boeing (C. C. A. 9), 106 Fed. (2d) 305, 308, cert. den. 308 U. S. 619;

Hawke v. Commissioner (C. C. A. 9), 109 Fed. (2d) 946, 950;

Bynum v. Commissioner (C. C. A. 5), 113 Fed. (2d) 1, 2;

A. R. Jones Oil, etc. Co. v. Commissioner, (C. C. A. 10), 114 Fed. (2d) 642.

A similar result obtains where the Tax Court's determination involves a disregard of evidence having a substantial tendency to prove a different result.

Farish v. Commissioner (C. C. A. 5), 103 Fed. (2d) 63, 64-65.

(a) Said Stock Was Issued to Petitioner June 9, 1919, and Ever Since He Has Exercised All Incidents of Ownership Thereof, Including Voting Said Stock and All Thereof at All of the Meetings of the Corporation Held Since Said Date.

In connection with the rights exercised by petitioner as a stockholder while said 1000 shares of stock were held by the depository, Mr. O'Brien testified [R. 220-1] that petitioner exercised all the rights set forth in the by-laws as the holder or owner of the stock; that petitioner voted said stock at all times while it remained in escrow; that petitioner participated fully in the direction of the affairs of the corporation at all times as a stockholder and was very valuable to the corporation; that at all times petitioner's stock was treated exactly as Mr. McAdoo's stock (which was never held by the depository); every stockholder had equal voting rights and equal rights in every respect in connection with their shares of common stock regardless of whether it was in or out of escrow; petitioner had the right to vote and the right to receive notices, and the right to have dividends voted on the stock. [R. 220-1.]

Petitioner from time to time as the owner of said 1000 shares of common stock executed proxies [Exhibits 21, R. 239; 24, R. 245; 25, R. 246, and 28, R. 249] and waivers of notice of meetings. [Exhibits 27, R. 248, and 29, R. 250.]

Petitioner in voting said stock and exercising all the incidents of ownership thereof, was exercising rights conferred upon him as a stockholder of the corporation. Dividends were declared though it is true that pursuant

to an independent contract between the corporation and petitioner and as security for the performance of his obligations under the distribution agreement the actual delivery of the moneys received from dividends to petitioner was deferred. The original preorganization agreement [Exhibit 1, R. 73] on page 4, provides in part as follows:

“The owner of said common stock shall be entitled to one vote for each share of stock owned by him or her.”

Under Article II, Section 1 of the By-Laws of United Artists Corporation [Exhibit 3, R. 93] it is provided in part as follows:

“Certificates evidencing the ownership of the preferred and common shares of the corporation of such tenor and design as the Board may from time to time adopt shall be issued to those entitled to them.”

All of the certificates of common stock under consideration in this case were issued to petitioner on June 9, 1919, and in compliance with the provisions of the by-laws, petitioner owned said shares and must be considered as the person entitled to them. Obviously, under the law stock cannot be issued without creating the relation of stockholder, assuming of course that there was consideration.

The so-called depositary agreement of August 5, 1919 [Exhibit 7, R. 143], in paragraph fifth provides:

“The depositary shall not have the right to vote the shares of stock deposited hereunder.”

and the certificate of deposit [Exhibit 12, R. 195] which was issued to petitioner upon the delivery of said 1000 shares of stock to the depositary pursuant to the agree-

ment of February 5, 1919 [Exhibit 5, R. 114] provides [R. 195]:

“The holder of this certificate of deposit shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation.”

In the case of *Semar v. Commissioner*, 27 B. T. A. 989, in connection with the interest of the petitioner in a contract entered into in the state of Washington, a community property state, prior to petitioner's marriage, the Tax Court stated:

“He was to be given its fruits; the right to enjoy the fruits being, of course, one of the most important incidents of ownership.”

The right to “enjoy the fruits” which petitioner was entitled to exercise in this case was that of voting the stock and exercising all other rights of a stockholder in directing the affairs of the corporation. The Tax Court again in the case of *Semar v. Commissioner, supra*, stated:

“We think as we have said that the petitioner here had an inchoate right to the stock in question before his marriage which does not because of subsequent acquisition of legal title and receipt of the stock certificates thereafter any the less constitute property owned before the marital community began.”

By the same token, the release of the stock by the depository to the petitioner in this case did not any the less constitute a change of ownership because petitioner became the owner of said 1000 shares of stock upon its issuance to him on June 9, 1919.

A case directly in point is that of *Snyder v. Duffy*, 43 Fed. (2d) 642, where the petitioner, a vice-president of a cigar company, entered into an agreement to remain with the company for a period of five years at a stipulated salary. In addition to the salary, he was entitled to receive 1500 shares of the company's stock at the rate of 300 shares each year during the five-year period. The taxpayer received dividend checks regularly upon the basis of 1500 shares of stock during the five-year period, and signed proxies for all meetings of stockholders. The Commissioner treated the receipt of certificates for 300 shares of stock in each respective year as equivalent to the receipt of income for that year to the extent of the value of the stock at the time of the receipt of the certificates. The contract was given the taxpayer in that case by the cigar company to persuade him not to leave the company and enter into a competing business. The question involved is whether or not the beneficial interest in the 1500 shares of stock vested in taxpayer at the time the contract was executed. In reference to the delivery of the stock, the court says:

"It cannot be maintained that actual physical possession is a necessary incident to the vesting of property. The general principle is quite to the contrary and holds that an interest in the property is vested when there is a present fixed right to the enjoyment of income from or increment of the property."

* * * * *

"It would appear therefore that when the actual ownership of the 1500 shares of stock was transferred to Mr. Snyder on March 1, 1916, he became the owner of all of said stock at that time despite the fact that the certificates 'mere evidence of the holder's owner-

ship of the stock and all his rights as a stockholder to the extent specified therein' were not delivered into his possession."

The court in the above case distinguished the features of the contract, and declared that the 1500 shares of stock was given taxpayer as an inducement not to leave the company and enter into a competing business, and therefore a beneficial interest vested in taxpayer in 1916 when the contract was entered into, and therefore the value of the 300 shares of stock received each year by taxpayer did not constitute income to taxpayer in the years in which received. The court further stated:

"That the contract transferred all of the rights of ownership in the 1500 shares of stock to Snyder subject only to the provisions of the contract which in reality constituted nothing more or less than a bond for faithful performance. . . . In the meantime it is true he had no right to sell the undelivered portions of the stock, but he had all the beneficial rights therein, and that is more than either the American Cigar Company, or the Seidenberg Co. had. All that Mr. Snyder had to do to acquire complete domination in the situation was to stay alive and to do what he had promised."

The court held:

"The subsequent installment deliveries of stock made from year to year being nothing more than an evidence of ownership already vested in no wise constituted taxable income for such years as saw their physical delivery to plaintiff."

In the present case, the beneficial interest in the 1000 shares of stock vested immediately in petitioner upon its

issuance, and the stock was held by the depositary as a bond for the faithful performance by petitioner of the terms of his distribution agreement [Exhibit 5. R. 114], to wit: the delivery of motion pictures to United Artists Corporation, just as the 1500 shares of stock in the *Snyder* case, *supra*, were held as a bond for Snyder's agreement not to enter into a competing business.

"It is established law that a stockholder is one who holds membership in a corporation by virtue of owning and holding one or more shares of its stock, . . . one who appears on the books of the corporation as the owner of shares and therefore entitled to a voice in the management and burdened with the liabilities incident to that relation . . . whether, as between the corporation and themselves, individuals stand in the relation of stockholders depends, as in other cases involving a contractual relationship, on the intention of the parties as manifested by a correct construction of the agreement in which they have entered"

Corpus Juris Secundum, Volume 18, Section 475,
Subparagraph A.

Measured by either of the foregoing general rules, there can be no question but what petitioner has been a stockholder of United Artists Corporation since June of 1919.

Measured by the laws of Delaware, the state in which United Artists Corporation was organized in which the foregoing rules of law are applicable, he must be held the owner of said stock for there even one who had subscribed for stock and the stock never even issued has been held a stockholder.

Hegarty v. American Com. Power Corp., Delaware
Chancery Reports, Vol. XX, page 231.

(b) Dividends Were Declared on Said 1000 Shares of Stock While Held by the Depositary and Placed in Trust for Petitioner's Benefit.

Section 5 of Article II of the By-laws of said corporation [Exhibit 3, R. 93] provides in part as follows:

"Dividends on the preferred and common shares, if declared, severally and respectively shall be payable . . . to the stockholders of record."

In view of the express language in the by-laws, the petitioner as the stockholder of record is the only person entitled to receive the dividends pursuant to the by-laws of said corporation, and the fact that said dividends are placed in trust for the benefit of petitioner as security for the performance of petitioner's obligation is not inconsistent with the established fact that petitioner was the registered stockholder of said stock; otherwise no dividends could have been declared upon said shares of stock. It is obvious and the fundamental law that a corporation cannot declare dividends upon its own shares of stock which the corporation owns since the stock does not constitute an obligation of the corporation until issued or reissued. (*Borg v. International Silver Co.*, 11 Fed. (2d) 147.)

Since the corporation did not own petitioner's stock while the same was held in escrow (otherwise no dividends could be declared thereon) it follows that ownership of this stock was vested in some one else. There is no evidence to indicate that the escrowholder or any one other than petitioner did own the stock. Although petitioner was not entitled to these dividends as and when paid, they

nevertheless did constitute his property and as such constituted taxable dividend income to him in the year paid. The fact that they were held in escrow pending the performance by petitioner of the terms of his picture contract and as security for the same would not release him from the obligation to pay taxes thereon in the year in which they were paid. Therefore these dividends, if taxable at all to petitioner, would have been taxable to him in the years when they were declared and paid and not in the year in which they were released to petitioner from escrow.

In the case of *William R. Hopkins v. Commissioner*, 41 B. T. A., decided May 29, 1940, petitioner agreed to purchase 570 shares of stock of the Buckeye Engine Company. The stock was placed in escrow with the trust company, and the petitioner had the right to withdraw any portion of the stock from the trust company at any time upon payment of the purchase price plus six per cent interest. All dividends were to be applied toward the payment of the stock. By 1926, the dividends on the stock had equalled the purchase price, and in 1930 petitioner made demand upon the trust company for possession of the stock. It refused to deliver possession of the stock to petitioner, and an action was instituted for recovery thereof. A decree was entered in petitioner's favor. The case was decided on appeal in 1933, and the Commissioner contended that taxpayer received this amount of income in 1933. The court in its opinion states:

"If petitioner owned this stock from 1920 and the dividends were paid for his account when they ac-

crued, there being no sale or exchange, the dividends were not income in 1933 when in their then present form they were accounted for pursuant to the court decree. Possession of the securities was retained as security against moneys advanced. Since the petitioner was at all times the owner of the stock, we pass to the question of the dividends. Physical receipt by the taxpayer is not always necessary in order to sustain an application of the rule. There may be a receipt by an agent which is regarded as receipt by the principal. The distributions from 1921 to 1930 were received by the trust company not as owners nor for the sellers, but for the petitioner as the equitable owner."

The facts in the above case are parallel to a great extent to the facts in this case. The petitioner owned the stock at all times after its issuance in 1919, and the dividends were paid into a trust account with the bank for his benefit. The bank paid interest on these dividends which interest was also turned over to the petitioner at the time the dividends were delivered to him.

Th Tax Court in the cases of *Bassett v. Commissioner*, 33 B. T. A. 182, and *Federal Development Co. v. Commissioner*, 18 B. T. A. 971, laid great stress upon the fact that interest was paid the owners of funds held by the depository for the security of the performance of an obligation, and in those cases the fact that interest was so paid was commented upon by the Tax Court as one of the things that led the Tax Court to conclude where ownership of the funds vested.

(c) The Corporation at All Times Considered and Treated Petitioner as the Owner of Said Stock After Its Issuance on June 9, 1919, in All Corporate Affairs.

Petitioner was at all times treated by United Artists Corporation and recognized by it as the owner of 1000 shares of its common stock from and after its issuance on June 9, 1919. This is illustrated by the fact that petitioner's name appears as the owner of said 1000 shares of stock in each of the alphabetical lists of stockholders published by United Artists Corporation on the following dates:

March 1925 [Exhibit 20, R. 238]
March 1920 [Exhibit 23, R. 244]
March 1921 [Exhibit 26, R. 247]
March 1924 [Exhibit 30, R. 252]
March 1927 [Exhibit 32, R. 254]
March 1926 [Exhibit 33, R. 255]
March 1928 [Exhibit 34, R. 256]
July 1928 [Exhibit 35, R. 257]
March 1930 [Exhibit 36, R. 258]
May 1929 [Exhibit 37, R. 259]
March 1929 [Exhibit 38, R. 260]
March 1933 [Exhibit 39, R. 261]
March 1932 [Exhibit 41, R. 263]

In a consent to the adjournment of the annual meeting of stockholders of July 1, 1935 [Exhibit 43, R. 265], there appears the following language:

"We the undersigned being the owners of all the common stock of United Artists Corporation do hereby

. . .

(signed)

CHARLES CHAPLIN—Owner of 1000 shares."

In the minutes of an adjourned annual meeting of stockholders [Exhibit 44, R. 267] there appears the following:

“There were present the following stockholders . . .
Charles Chaplin . . .”

and at the end of the minutes, there appears:

“Minutes approved:
(signed) . . .

CHARLES CHAPLIN—Owner of 1000 shares.”

A similar reference is made to Charles Chaplin as “owner of 1000 shares” of common stock of United Artists Corporation in Exhibits 45, R. 269; 48, R. 273; 49, R. 275; 50, R. 277; 51, R. 279, and 52, R. 281.

Reference is made to Exhibits 49, R. 275 and 50, R. 277, for the purpose of showing that petitioner was treated by United Artists Corporation as the owner of 1000 shares, both prior to September 20, 1935, when the last 334 shares of the stock issued on June 9, 1919, were delivered over to him by the depository, and after said date when he had possession of the certificates of stock evidencing the full 1000 shares.

The stock certificates themselves [Exhibit 4, R. 111] evidencing said 1000 shares issued to the petitioner on June 9, 1919, provided in part as follows:

“This is to certify that Charles Chaplin is the owner of . . . common shares . . . of United Artists Corporation.”

Said shares when reissued to petitioner on October 31, 1928 [Exhibit 9, R. 166], provided in part:

“This is to certify that Charles Chaplin is the owner of . . . common shares of . . . United Artists Corporation.”

The corporation in its stock journal, which it furnished the Corporation Trust Company [Exhibit 13, R. 201] shows 1000 shares of common stock to have been issued to Charles Chaplin on June 9, 1919, and reissued to him on October 31, 1928, which reissuance took place pursuant to an amendment of the agreement of February 5, 1919 [Exhibit 5, R. 114] by the agreement of November 22, 1924. [Exhibit 8, R. 148.] And again, Mr. Dennis F. O'Brien in his affidavit of July 25, 1930 [Exhibit 16, R. 296] made at a time when he was a director and attorney for United Artists Corporation, which affidavit was made in connection with corporate matters in which United Artists Corporation was involved in Great Britain, states in part:

“I am duly authorized to make this affidavit on behalf of each of the companies,”

and on page 3 of said affidavit, paragraphs 9 and 10, stated:

“In 1924 (this date is incorrect and should have been (1919) the American Company issued to Mr. Charles Chaplin, Mr. Douglas Fairbanks, and Mrs. Mary Pickford Fairbanks and Mr. D. W. Griffith, each of them 1000 shares of Common stock of no par value.

“When the American Company was incorporated, the Artists, for themselves and their Producing Corporations, entered into agreements to deliver an agreed number of films over an agreed period of years, and as some security for their fulfilling this obligation, it was arranged that all their shares of Common Stock should be deposited with me to be held by me in escrow and as and when the films from time to time were delivered, I released the shares of Common Stock to them, or as directed by them. The said shares at all material times belonged to and were in the names of the said Stockholders.”

In connection with the agreement of November 22, 1924 [Exhibit 7, R. 143], there appears in an excerpt from the minutes of a special meeting of the board of directors dated August 25, 1932 [Exhibit 40, R. 262] the following language:

“It was stated to the meeting that the financial records of the corporation show that at the time of the execution of the aforesaid agreement dated November 22, 1924, all of the preferred and common stock of the United Artists Corporation then outstanding was owned by Mary Pickford Fairbanks, Douglas Fairbanks, Charles Chaplin, David W. Griffith and D. W. Griffith, Inc., subject to certain then existing escrow agreements pertaining to the common stock.”

Had he not been the owner of said shares of stock, would the corporation in preparing alphabetical lists of

stockholders have listed him as the owner of 1000 shares of common stock? Would the corporation have permitted him to sign minutes as "owner of 1000 shares", or would a director and the general counsel of the corporation for and on its behalf have made an affidavit in which he stated that petitioner was on the date thereof and at all times after its issuance the owner of 1000 shares of common stock, or would the corporation in signing a contract, refer to him as the owner of 1000 shares of common stock? There is absolutely no evidence in the record in this case in which petitioner was treated otherwise than as the owner of said 1000 shares of stock at all times, nor is there anything in said record that indicates any question arising as to his ownership of said stock.

Further and most persuasive evidence that petitioner was the owner of said 1000 shares of stock at all times is the reference in the agreement of November 22, 1924 [Exhibit 8, R. 150] wherein it is stated:

"Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all the preferred and common stock of the corporation now issued and outstanding."

Here we have positive and convincing evidence in the form of a contract executed by the corporation's stockholders in which the stockholders all agreed that petitioner is the owner of said 1000 shares of stock. It is worthy of note that said declaration was contained in the agreement executed at least eleven years before this tax controversy arose.

- (d) The Consideration for the Issuance of Said 1000 Shares of Stock Was the Execution by Petitioner of the Distribution Agreement of February 5, 1919.

The consideration for the issuance of 1000 shares of common stock to petitioner [Exhibit 4, R. 111] was the execution by petitioner of the agreement of February 5, 1919. [Exhibit 5, R. 114.] In said agreement it is recited on page 1 that petitioner was well and favorably known to the theatre-going public. That he has been extensively advertised throughout the world wherever motion pictures have appeared, and that the corporation is desirous of inducing petitioner to produce a series of special feature photoplays, and of having petitioner give to it the exclusive right to distribute said photoplays pursuant to the terms of said agreement, and said agreement on page 10 provides:

“And in addition to the above consideration, one thousand (1000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation nine photoplays.”

The “consideration” referred to above was the agreement upon the part of the corporation to market, distribute, exploit, and cause to be exhibited photoplays produced by petitioner in accordance with the terms and conditions of said agreement.

Mr. Chaplin [R. 323], testified that at the time United Artists Corporation was formed, Miss Mary Pickford was the most important female star in the motion picture business; that Douglas Fairbanks was the first gentleman of

the motion picture industry, and a very important star in the industry, and that D. W. Griffith was recognized as the greatest director at that time. That all four of those individuals, including himself, were constantly in demand by other companies, and received numerous propositions from other companies to produce photoplays for distribution.

Mr. Chaplin also testified that because of the unusual and outstanding abilities and favor with the public of Miss Pickford, Mr. Fairbanks, Mr. Griffith and himself, the execution of the agreement of February 5, 1919 [Exhibit 5, R. 114], and the agreement to subscribe to preferred stock of United Artists Corporation, and the execution of the respective distribution contracts [Exhibit 5, R. 114] was a fair consideration for the issuance of common stock. [R. 324.]

In Exhibit 1, page 1, in making reference to petitioner. Douglas Fairbanks, David W. Griffith, and Mary Pickford, it is stated:

“All of the above named persons are well and favorably known, and their respective names have exceptional trade value in all parts of the world where motion pictures have been exploited and exhibited.”

Mr. O'Brien testified [R. 185] in answer to the question:

“Q. I will ask you why when the corporation was actually organized it was organized under the laws of the State of Delaware? A. Because Mr. Joseph F. Cotton, who was representing Mr. McAdoo desired the corporation to function under the laws of Delaware so to be sure there would be no question as to the proper consideration paid for the issuance of the

stock. He wanted that absolutely clear. He wanted the title to the stock in so far as Mr. McAdoo's 1000 shares were concerned to be without any question. There was some doubt about the laws of the State of New York inquiring into the propriety and accuracy of the consideration."

As shown by Exhibit 14, R. 205, the corporation issued 5000 shares of stock as consideration for the execution by the various individuals of their four distribution contracts. One thousand shares were issued to each of these individuals, and 1000 shares were issued to Mr. McAdoo. There was some question as to whether or not the execution of such contracts would constitute proper consideration for the issuance of said stock under the laws of New York; so instead of incorporating the company as a New York corporation as provided in Exhibit 1, [R. 73] the corporation was incorporated under the laws of the state of Delaware.

Mr. O'Brien, in answer to the question [R. 186]:

"Q. I will ask you what is the consideration for the issuance of those 5000 shares of common stock?"
said:

"A. It is the consideration that is set forth in the minutes of the first meeting, which I acted as secretary, if I remember correctly, and it was the delivery of the contract not the fulfillment, and the by-laws are all drawn in keeping with that basis and that theory."

And Mr. O'Brien was asked [R. 187]:

"Q. And are those the 1000 shares of stock that were issued to Mr. Chaplin as consideration for the execution of the agreement of February 5, 1919 [Exhibit 5, R. 114]? A. That is my understanding."

As further evidence of the fact that petitioner became the owner of the 1000 shares of common stock upon its issuance on June 9, 1919, there is an entry in the journal of United Artists Corporation in June of 1919 [Exhibit 14, R. 205], as follows:

“June 9 Artists’ Contracts A-4	\$25,000.00
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Consideration for contracts with the four artists for delivery of photoplays to Corporation as per resolution of Board of Directors adopted May 29, 1919 (ratified by stockholders Sept. 9, 1919)

Capital stock—Common C-7	\$25,000.00
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Issued 5000 shares at no par value, but regarded to have a value of \$5.00 per share (verbal advice of General Counsel)."

It is submitted that United Artists Corporation could not have made entries in its books of account similar to the foregoing had it not regarded the execution of the various contracts by the parties who caused it to be organized, including petitioner, to have been proper and sufficient consideration for the issuance of the shares of stock, and if the execution of the contracts furnished the consideration for the issuance of the stock, how could it be contended that petitioner did not become the owner of 334 shares of this stock until 1935 when the actual contract itself [Exhibit 5, R. 114] was executed by petitioner on February 5, 1919?

In the minutes of the special meeting of the Board of Directors held on May 29, 1919 [Exhibit 18, R. 231], the following resolution appears:

“Resolved that, in consideration of the delivery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are, author-

ized to issue and deliver to William G. McAdoo, Esq., one thousand (1000) shares of no par value of this corporation . . .; and

“Resolved that, in consideration of the delivery of said contracts to this Corporation, the proper officers of this Corporation be, and they hereby are, authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore professionally known as Mary Pickford) one thousand (1000) shares of no par value each, making a total of four thousand (4000) shares. . . .”

The foregoing resolutions themselves show that *the delivery of the contracts to the corporation was the consideration for the issuance of the shares of stock*. This being true, there is no foundation whatever for claiming that the delivery of photoplays was a prerequisite to petitioner becoming the owner of his full 1000 shares of stock.

In Exhibit 55, R. 289, which is a letter from John Fairbanks (brother of Douglas Fairbanks) to Hon. William G. McAdoo, dated March 15, 1919, which is after petitioner had already signed his distribution agreement of February 5, 1919 [Exhibit 5, R. 114], Mr. Fairbanks states:

“Each one of the five stars were to subscribe for one hundred thousand dollars (\$100,000) worth of this preferred stock and they were to get one thousand (1000) shares each of common stock for signing the contract. . . .”

The stock therein referred to was, of course, stock of United Artists Corporation, and the contract therein referred to was the distribution contract. [Exhibit 5, R. 114.] The five stars therein referred to included William S. Hart, who contemplated becoming one of the organizers of United Artists Corporation but subsequently withdrew.

Mr. Chaplin in his testimony [R. 321] in answer to the question:

“Q. Well, do you recall what the consideration was for the issuance of the common stock?”

said:

“A. For the signing, yes, for the signing—make a contract with the company.

Q. The distribution contract? A. Distribution contract.”

In the case of *Ambassador Petroleum Company v. Commissioner*, 28 B. T. A. 868, petitioner agreed to pay \$15,000 in cash and 105,000 shares of its stock for a leasehold interest in certain property in 1920. The stock was not issued until 1923. In 1924, petitioner abandoned the lease and took as a loss in its tax return the sum of \$120,000 representing \$15,000 paid in cash and 105,000 shares of its stock at a value of \$105,000. Petitioner contended that \$105,000 was the reasonable value of said stock in 1920, although it was not issued until 1923. The Tax Court in its opinion stated:

“Where a corporation agrees in 1920 to issue its capital stock in part payment of its property but does not actually issue the stock until 1923, the basic date

for the valuing of the stock to determine the cost of the property is in 1920 when the obligation to issue the stock was incurred.”

Section 3 of the Delaware Corporation Law provides as follows:

“Section 3: No corporation shall issue stock except for money paid, labor done, or personal property or real estate or leases thereof actually acquired by such corporation.”

Reference has heretofore been made in this brief to the fact that the state of incorporation of the corporation was changed from New York to Delaware in order that there might be no question regarding the proper consideration paid for the issuance of the stock. Obviously the only consideration received by the corporation for the issuance of the stock that would come under Section 3 of the Delaware law above quoted would be personal property. That personal property would naturally be the contract of February 5, 1919 [Exhibit 5, R. 114] in which the consideration for the issuance of the stock to petitioner was therein recited. The corporation could not issue the stock to itself since it did not theretofore own the contract. The contract came from the petitioner, and any stock issued in payment of the same would naturally be issued to petitioner. The mere fact that the stock when issued was placed in escrow would not change the ownership thereof. It has become a common custom of placing stock in escrow when issued, particularly in states having so-called “blue sky” laws, where there is some element of promotion involved or where there might be some question as to the value of the consideration received for the issuance of the stock.

(e) Said 1000 Shares of Stock Were Placed With a Depositary as Security for the Performance by Petitioner of a Distribution Agreement Entered Into Between United Artists Corporation and Petitioner on February 5, 1919.

The organizers of United Artists Corporation being persons of long standing in the motion picture business were thoroughly familiar with the requirements of a corporation organized for the sole purpose of distributing motion picture photoplays. They knew that such a corporation would have to be continually supplied with photoplays in order to meet the requirements of its exhibitors, and being able to keep the exhibitors supplied with motion pictures at all times. They were also cognizant of the fact that the motion picture business was a hazardous one, and that there were continual changes in management, reorganization and similar changes, which made it an uncertain business. They fully appreciated the fact that each of the organizers of United Artists Corporation was one of the outstanding—if not the most outstanding—male or female star or director in the industry at that time. Each of these persons was in great demand, and received offers from other companies to distribute their motion pictures. For these reasons at the time the respective artists signed their distribution agreements [Exhibit 5, R. 114] under which they agreed to deliver to the corporation nine motion pictures within a period of three years, they wanted to give each individual all possible incentive to live up to this contract so that dividends would be larger. The safest method they could conceive at the time of guaranteeing each to the other that they would deliver the pictures called for in their contracts was to require their shares of common stock issued to them as consid-

eration for the execution of the contracts to be placed with a depositary along with all dividends that were declared thereon, and for said shares of stock and dividends to be delivered to said individuals on a *pro rata* basis at the time or times they delivered to the corporation pictures for distribution pursuant to the terms of their respective contracts. In this connection, Mr. Chaplin in his testimony [R. 319] testified:

“A. . . . I think, as I say, the question of the 1000 shares of common stock, putting them in escrow, was a part of good-will and an added security for the company in order that we would carry out the terms of our signed contract distributing pictures.”

Mr. O'Brien, an officer and attorney for the corporation who took part in its organization, and has been its general counsel since 1920, with respect to the reasons for escrowing the stock, testified, as follows [R. 213]:

“It was in conformity with the basic agreement in the very last paragraph, as I recollect it, in which they agreed to do certain things with the corporation and for the benefit of each other, and so forth, and that in my opinion that part of that basic contract was never supplemented by any other act done by the parties thereto.

From the very beginning it was the desire—as took place in the discussions and as carried out by the attorneys representing the four participants—that they would own their own corporation. They would have no foreign interest represented in that corporation, and they were going to do as far as they were able, and as far as their attorneys could advise, to put the addition of such a foreign interest—to make

it practically impossible. They had one prohibition in there about the sale of the stock: it would have to be offered to each of the others before it could be sold. Of course, that didn't protect them completely, because the sale price might be way beyond what they would care to pay for it and that foreign interest might come in, just as we had had in another corporation we were in where Miss Pickford had half of the stock, yet that didn't prevent the other half from turning this over to Paramount. The other was that as evidence of their good faith and as their desire to have this whole thing on as near a spirit of equality without one profiting on the stock of the other, so that each one would be entitled to sharing in the number of pictures that was delivered by that person to the others, we all knew, and it was very apparent that these four producers would all start at different times. Mr. Chaplin had quite a burden ahead of him before he would complete his contract, and as it was, it wasn't completed within the three year period. Douglas was nearly ready, and he would start first. And D. W. Griffith came along then, and then Mary had either one or two pictures to finish with First National. Now, then, by putting that stock and the dividends and security for their particular promises to each other and to this corporation, it made it nearly prohibitive for anybody getting into that corporation other than a producer and a producer of the type of motion pictures that would sell themselves and not be sold by other pictures. And that worked out pretty nearly in keeping with what it was originally planned, to make it cooperative. In other words, Douglas had seven pictures delivered. His stock and security and the dividends, if any, coming up. Now, then, Charley would have to deliver an equivalent amount of pictures, or as subsequently

worked out, pictures that grossed equal to the amount of Douglas before he really got the earnings.

It was an equal basis. There was never any thought but what that was the stock of the owners. Otherwise the corporation couldn't function. It would violate every provision of its by-laws and of its incorporation papers. They had the right to vote it and did vote it. It is my belief that when those dividends were declared they then belonged to the owners and the tax then should be paid on them."

In paragraph third, page 6, of the original preorganization agreement [Exhibit 1, R. 73] it is provided:

"Each of the parties hereto agrees with each other and with all the others and with said corporation and for the benefit of all the parties hereto to execute and deliver a contract with said corporation for the sole and exclusive license to market, exploit, distribute, and turn to account the motion pictures that each shall produce. . . ."

The foregoing seems to be a basis for the deposit of stock of each producing owner as security for the "benefit of said corporation and for the benefit of all the parties hereto"; the benefit of the corporation being the security for the performance by the producing owners, and for the benefit of each other to the extent of providing sufficient high-class motion picture photoplays to enable the corporation to function effectively.

The balance sheet of the corporation of October 1919, seven months after the organization of the corporation

contained an item "Artists contracts \$25,000.00" under assets, and under liabilities "Capital stock common \$25,000.00."

In the case of *Federal Development Co. v. Commissioner*, 18 B. T. A. 971, petitioner in March of 1919 entered into an agreement for the sale of certain real property for \$963,500. The property at the time was occupied by Fairbanks Co. as lessee. The purchaser withheld the sum of \$50,000 as a guaranty against his failure to obtain possession of the premises on March 1. 1920. The purchaser agreed to pay interest on the sum of \$50,000 during the time it retained the same. Petitioner contended that the \$50,000 was not received by it in 1919 and it was not possible to determine what portion thereof it would receive until the following year. The court held that the act of the purchaser in paying over the entire amount of the purchase price and then receiving back a deposit of \$50,000 makes no difference. The sum was held from time to time as money belonging to the petitioner, interest being paid the latter for the time it was held. The court in its opinion stated:

"The fact that one who sells property guarantees the purchaser against some contingency arising in a future year and makes a deposit as security for the guarantee does not lessen by the amount of the guarantee or the amount of the deposit the profit which he had made on the sale."

In the present case, petitioner received interest on the dividends while they were held in trust for petitioner,

and as stated in the above case it was immaterial that the stock and dividends did not come into petitioner's hands and then be placed with the depository. The stock and dividends were held and remained as a security for the performance of petitioner's obligation, to-wit: the delivery of motion pictures, and the fact that they were so held does not lessen or dispute the fact that petitioner became the owner of his stock when the same was issued on June 9, 1919.

Another case directly in point is that of *H. L. Carhahan v. Commissioner*, 21 B. T. A. 893. In that case the Union Mortgage Co. was organized in 1921 and 1922 received a permit from the Commissioner of Corporations of the state of California to sell 100,000 shares of its common stock at \$12.50 per unit. In 1922, petitioner, an attorney, was engaged to render legal services to the corporation for which he was to receive 10,000 shares of said common stock. The services were rendered by the attorney in 1922, and in that year he received an interim trust certificate for the stock. The stock was later transferred to him in December of 1922, but was then deposited by him with a depository approved by the Commissioner of Corporations to be held in escrow until further order of the Commissioner. In 1924, the escrow was terminated, and the stock was delivered to said attorney. Dividends were paid to the attorney on the stock held in escrow in October of 1923, and he voted the stock at all times. The question presented was whether or not the stock constituted income to him in 1922, the year in which his ser-

vices were rendered and the stock issued, or 1924, when it was released from escrow and delivered to petitioner. The Tax Court in its opinion emphasized the fact that during the time the stock was held in escrow, the attorney voted the stock and received the dividends thereon. Furthermore, he received the certificate for the stock which was issued in his own name and deposited it in escrow in accordance with the requirements of the state law. The Tax Court stated that he received all the benefits possible from the stock in question except the right of actual physical possession and unrestricted power of sale thereof, and, therefore, the stock constituted income to him in 1922 and not in 1924 as contended by the respondent. In the present case, petitioner likewise enjoyed all the incidents of ownership of his stock while in escrow, including voting the stock at all times. It is true that petitioner's dividends were held for him in trust as security for the performance of his obligation to deliver pictures as was the stock. This did not in any way, however, diminish his legal ownership of his stock, or the dividends, but merely delayed the time when he would come into physical possession thereof.

(f) The Dividends Declared on Said Shares of Stock While in the Possession of the Depositary Were Impounded to Encourage Compliance by Each Artist With His Distribution Contract.

It is submitted that one of the most important reasons for placing the stock with the depositary in this case was to prevent the various stockholders from receiving dividends on their shares of common stock until such time as they had delivered to the corporation motion pictures. The stock certificates themselves [Exhibit 4, R. 111], as well as the by-laws of the corporation [Exhibit 3, R. 93], contained restrictions upon the transferability of the stock. These restrictions made it impossible to transfer these shares of stock to anyone other than the stockholders of United Artists Corporation. Consequently the corporation could have delivered to petitioner his 1000 shares of stock when issued in 1919 and still have had the same protection had it required the dividends on the stock to have been held in escrow for petitioner until such time as he delivered to the corporation motion pictures. It would have been manifestly unfair for a producer to have received dividends on his shares of stock resulting from the release by said corporation of pictures produced by other artists when he had not delivered to the corporation any pictures of his own. The dividends, therefore, were required to be placed in trust for petitioner, as well as the other stockholders, to encourage the speeding up of production of their pictures.

(g) The Terms of Petitioner's Contract so Far as the Same Related to the Number of Photoplays Required to be Delivered and the Time of Delivery Were Abandoned Both by United Artists Corporation and by Petitioner.

Petitioner's distribution contract [Exhibit 5, R. 114] called for nine pictures to be produced within three years. These pictures were to be from 1600 to 3000 feet in length. Petitioner departed from this type of picture in the very beginning because he thought the subject matter warranted a longer length picture, and he was not as he thought restricted to any particular length of picture. [R. 316.]

Each picture produced by petitioner pursuant to his distribution contract [Exhibit 5, R. 114] was in excess of 5000 feet in length. Having entered upon a program of making motion pictures much longer in length than those contemplated in the distribution agreement, it would have been impossible for petitioner to have made nine pictures within the three-year period called for. As a matter of fact, petitioner by reason of previous commitments and increasing the length of pictures was unable to deliver a single picture to United Artists Corporation within said three year period. There was no extension of his contract or amendment thereof granting petitioner a longer period of time to produce said pictures. Notwithstanding this fact, petitioner's stock was not forfeited or turned back to United Artists Corporation, as was provided in Exhibit 7 [R. 143], nor was any demand made

upon the depositary or petitioner by United Artists Corporation or any stockholder, director or officer thereof for the return of said stock. It is true that on November 22, 1924 there was an agreement entered into [Exhibit 8, R. 148] which provided that petitioner would be obligated to deliver to the corporation five additional motion picture photoplays instead of eight undelivered pictures provided in said distribution agreement of February 5, 1919. [Exhibit 5, R. 114.] On November 22, 1924 petitioner had delivered to the corporation one motion picture pursuant to his distribution agreement. Said agreement of November 22, 1924 [Exhibit 8, R. 148], further provided that all five of said remaining motion pictures should be delivered by petitioner on or before January 1, 1929. Notwithstanding this fact, petitioner only delivered to said corporation two pictures prior to January 1, 1929, namely, *THE GOLD RUSH*, on August 16, 1925, and *THE CIRCUS* on January 7, 1928. There was no extension of this contract; nevertheless, no default was claimed by any one that petitioner had defaulted under his contract, nor was any demand made that the shares of common stock issued to him and held by the depositary at that time should be returned to the corporation. As further evidence of the fact that petitioner and the corporation considered petitioner to be the owner of the 1000 shares of common stock at all times, petitioner would have been entitled to receive a certificate for 167 shares of stock upon the delivery of *THE GOLD RUSH* on August 16, 1925, and a certificate for 166 shares upon the delivery of *THE CIRCUS*

on January 7, 1928. Nevertheless, these two certificates were not delivered to petitioner until November 8, 1928. This is further evidence of the fact that petitioner considered himself the owner of this stock at all times, and he was not worried or even interested in getting the stock out of the possession of the depositary as soon as he delivered each picture. The evidence in this case fully bears out the fact that the corporation and the various artists owning stock in the corporation were only interested in seeing that the corporation received pictures to distribute from time to time. They were not worrying about their shares of common stock. As a matter of fact, not a single one of them produced and delivered to the corporation their full quota of nine pictures within the three-year period called for in their contracts. Petitioner departed entirely from his original plan of producing two-reel or three-reel pictures. That the petitioner was not required to deliver the full nine pictures called for under his distribution agreement or even the six contemplated under the amended agreement of November 22, 1924, in order to become the owner of the 1000 shares of common stock is borne out by the fact that he only produced four motion pictures for United Artists Corporation during the period from February 5, 1919, the date of his contract, to September 20, 1935, the date on which the 334 shares of stock were delivered to petitioner. No agreement was entered into in the meantime reducing the number of pictures the petitioner was required to produce. As a matter of fact, petitioner never delivered to said corporation

a single picture within the period of time required under the agreement of February 5, 1919 or the agreement of November 22, 1924, nor did he deliver any pictures in order to get the 334 shares of stock delivered to him in 1935 as was required under his contracts.

If petitioner was not the owner of the 1000 shares of stock during all of this period of time, he would have had no legal right under the articles and by-laws of the corporation to vote the stock, attend directors' meetings, receive notices, etc., and this is true regardless of the fact that the escrow agreement [Exhibit 7, R. 143] gave petitioner the right to vote his stock. The right to become a shareholder in a corporation is subject to such qualifications and restrictions as may be established by the articles or the by-laws for shareholding. (6a *Cal. Jur.*, 357 and 247.)

As heretofore pointed out, a stockholder is one who appears on the books of the corporation as the owner of certain of its shares of stock, and, therefore, is entitled to a voice in the management and burdened with the responsibilities incident to the relationship. (*Lee v. Reifler & Sons*, 43 Fed. (2d) 364.) Petitioner in this case exercised a full voice in the management of the affairs of the corporation at all times. Had he not been the owner of this stock, all rights which he exercised as the owner thereof while it was held by the depositary would have been prohibited by the by-laws of the corporation. Where a corporation under Section 19, Delaware Corpo-

ration Laws, acquires shares of its own stock, this stock cannot thereafter be voted directly or indirectly so long as it is owned by the corporation.

United Artists Corporation by executing the distribution agreement [Exhibit 5, R. 114] obligated itself to issue said 1000 shares of stock to petitioner. The stock was issued pursuant to this obligation on June 9, 1919. Ever since said date petitioner has voted said stock as a stockholder, has executed proxies, has had his representative act, or he himself has acted, as a director of said corporation. This corporation for sixteen years preceding the year concerning which this controversy arose, kept full and complete records, rendered its reports to the state of Delaware, prepared and filed tax returns, and in every manner carried on a successful, legitimate business, and had its records closely supervised and examined. The action of the respondent in treating this 334 shares of stock as income to petitioner in 1935 is the first and only contention by anyone that petitioner had not owned said stock since 1919.

Conclusion.

In conclusion, it is submitted that the record in this case shows that petitioner became the owner of the 334 shares of stock in question upon its issuance on June 9, 1919; that the consideration for said stock was the execution by the petitioner and delivery to the corporation of the distributor's contract; that during all of the time the stock was held by the depositary, petitioner exercised all incidents of ownership of said stock, except the physical possession of the certificates themselves and the dividends declared thereon; that the corporation in all corporate affairs, records, contracts, and transactions regarded him at all times as the owner of the stock; and that the stock was placed with a depositary as a guarantee by petitioner of the performance of the terms and conditions of his distributor's agreement, to-wit: the production and delivery of pictures to United Artists Corporation. That although petitioner failed to deliver to United Artists Corporation the requisite pictures called for under his contract, nevertheless no forfeiture of his stock took place, and petitioner realized no income by reason of the release of 334 shares of stock in 1935.

Respectfully submitted,

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No. 10245

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

CHARLES CHAPLIN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

CHARLES CHAPLIN,

Respondent.

REPLY BRIEF FOR PETITIONER,
CHARLES CHAPLIN.

FILED

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Respondent.

REPLY BRIEF FOR PETITIONER, CHARLES CHAPLIN.

As most of the argument presented in the brief for Commissioner is answered in the brief for petitioner, Charles Chaplin, heretofore filed, this reply will be addressed to only two points which we feel require any special comment.

I.

This Court Is Entitled to Review the Conclusion Reached by the Board of Tax Appeals That the Shares of Stock Here Involved Did Not Become the Property of Petitioner, Charles Chaplin, Until Delivered by the Depositary to Him.

At page 19 of the brief for Commissioner it is argued that "the issue here is whether the evidence *requires* a conclusion contrary to that which was reached below." The point of the argument for Commissioner seems to be that where the Board of Tax Appeals announces a conclusion of law, that conclusion is binding upon this court if it can be said that there was any substantial evidence in the record to support it.

This is not the law. It is well settled, by a long line of decisions, including those of this court,

"The ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact. It is to be distinguished from the findings of primary, evidentiary or circumstantial facts. It is subject to judicial review and, on such review, the court may substitute its judgment for that of the Board."

The above quotation is taken from *Helvering v. Tex-Penn Oil Co.*, 300 U. S. 481, 491; 81 L. Ed. 755, 762. To the same effect is the decision of the Supreme Court in the case of *Bogardus v. Commissioner*, 302 U. S. 34, 39, 82 L. Ed. 32, 36.

The foregoing statement of the rule is approved and carefully considered by this court in the case of *Commissioner of Internal Revenue v. Boeing*, 106 F. (2d) 305, 308, and also in the case of *Hawke v. Commissioner of Internal Revenue*, 109 F. (2d) 946, 950.

The decision of the Board of Tax Appeals makes findings of “primary, evidentiary and circumstantial facts” from which that court made the ultimate finding or conclusion of law that the stock in question was not the property of Mr. Chaplin until the year 1935, when the certificates evidencing said shares were delivered by the depository to Mr. Chaplin. It is plain that under the rule of the decisions above referred to, as well as other decisions on the same question which are cited on page 19 of the brief for petitioner, Charles Chaplin, this court not only has the jurisdiction so to do, but indeed, it has the duty fully to consider the matter and to substitute its own judgment for that of the Board of Tax Appeals if it shall conclude that the Board of Tax Appeals was mistaken in the conclusion reached. See also *Farish v. Commissioner of Internal Revenue*, 103 F. (2d) 63, 64.

II.

The Validity of the Ultimate Finding of the Board Is to be Tested by What in Fact Was Done Rather Than by the Mere Form of Words Used in the Writings Employed.

It is argued in the brief for Commissioner that because the stock was delivered into “escrow” rather than having first been delivered to Mr. Chaplin and then pledged by him to United Artists Corporation, there can be no possible validity to the claim that the transaction involved was in fact a security transaction. This argument is not logical. An agreement which takes the form of an “escrow” may as well be one for security as for any other purpose. If the parties themselves treated the transaction as one by which title to the stock was vested in Mr. Chaplin and he became the owner thereof, the fact that it was delivered

by the corporation to an "escrow" does not change the essential characteristics of the transactions between the parties. The Commissioner apparently contends, at page 25, that a deed is delivered as an escrow when the delivery is conditional and from that asks that the conclusion be reached that because it was an escrow it could not be a transaction wherein the escrow holder held the certificates as security.

It is well established that in applying the provisions of the Sixteenth Amendment of the Constitution and income tax laws enacted thereunder, courts should regard substance rather than mere form and should give effect to the intention of the parties as shown by all the facts and circumstances surrounding the transaction.

Helvering v. Tex-Penn Oil Co., 300 U. S. 481, 493.
81 L. Ed. 755, 763;

Commissioner of Internal Revenue v. Southern Bell Telephone & Telegraph Co., 102 F. (2d) 397, 402.

In the instant case, the Board of Tax Appeals made its preliminary, evidentiary and circumstantial findings in accordance with the evidence offered and received on behalf of the petitioner, Charles Chaplin, and this evidence shows without any substantial contradiction that the real purpose and intention of the parties was at all times to make Mr. Chaplin the owner of the stock at the time the stock was delivered to the depositary, subject to defeasance in the event Mr. Chaplin failed to perform his contract to deliver pictures to the corporation.

Conclusion.

Other points raised in the brief for the Commissioner are fully covered in the brief for petitioner, Charles Chaplin, heretofore filed and the argument advanced in petitioner's brief will not be here repeated. This applies particularly to the argument in the Commissioner's brief that the decision of the Board on the question of dividends is erroneous.

The decision of the Board of Tax Appeals should be reversed on the taxpayer's appeal and affirmed on the Commissioner's appeal.

Respectfully submitted,

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No. 10245

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

CHARLES CHAPLIN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES CHAPLIN, RESPONDENT

**ON PETITIONS FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS**

BRIEF FOR THE COMMISSIONER

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**In the United States Circuit Court of Appeals
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No. 10245

CHARLES CHAPLIN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES CHAPLIN, RESPONDENT

*ON PETITIONS FOR REVIEW OF THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS*

BRIEF FOR THE COMMISSIONER

OPINION BELOW

The opinion of the Board of Tax Appeals (R. 20-45) is reported in 46 B. T. A. 385.

JURISDICTION

This case involves the income tax liability of Charles Chaplin for the calendar year 1935. Notice of deficiency was mailed on March 2, 1939 (R. 5, 16), and the petition for redetermination was filed with the Board of Tax Appeals on May 26, 1939 (R. 1), pur-

suant to Section 272 (a) of the Internal Revenue Code. The decision of the Board of Tax Appeals was entered on April 6, 1942. (R. 46.) The taxpayer filed a petition for review on June 8, 1942 (R. 47-54) and the Commissioner filed a petition for review on July 1, 1942 (R. 56-62). By an order of this Court entered on August 1, 1942, the cases have been consolidated for briefing, hearing, argument and decision upon a single consolidated transcript of record. (R. 334-335.) The jurisdiction of this Court rests upon Sections 1141-1142 of the Internal Revenue Code. As of October 22, 1942, by Section 504 of the Revenue Act of 1942, the name of the United States Board of Tax Appeals was changed to The Tax Court of the United States. Although the decision of the Board and the petitions for review were filed prior to that date, since the record was prepared subsequent thereto by the clerk of that tribunal he captioned the record "Upon Petitions to Review a Decision of the Tax Court of the United States."

QUESTIONS PRESENTED

In 1935 the taxpayer received certain shares of stock together with "accrued dividends" thereon from a depository who held the stock in escrow under an agreement pursuant to which the stock was to be delivered to the taxpayer only upon the performance by him of certain conditions.

1. Does the record compel a conclusion that the Board erred in holding that the stock and "accrued dividends" were taxable as income to the taxpayer in 1935?

2. Was the item designated “accrued dividends” a dividend within the meaning of Section 25 (a) (1) of the Revenue Act of 1934 so as to be free from normal tax?

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition*.—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

(a) *Credits for Normal Tax Only*.—There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

(1) *Dividends*.—The amount received as dividends from a domestic corporation which is subject to taxation under this title.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend*.—The term “dividend” when used in this title (except in section 203 (a) (4) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of

its earnings or profits accumulated after February 28, 1913.

STATEMENT

The facts, as found by the Board of Tax Appeals, may be summarized as follows:

On February 5, 1919, the taxpayer, and Douglas Fairbanks, Mary Pickford and David W. Griffith entered into an agreement to associate themselves in the distribution of motion pictures thereafter produced by them. All of the parties were favorably known in all parts of the world where motion pictures were exhibited and their respective names had exceptional trade value. The agreement provided, *inter alia*, that they would organize a corporation to be known as the United Artists Corporation. The capitalization of the corporation was to consist of 6,000 shares of eight percent, \$100 par value, cumulative, preferred stock and 9,000 shares of no par common stock. Each of the parties was to purchase 1,000 shares of the preferred stock at \$100 per share, but it was contemplated that this stock would be redeemed by the corporation. (R. 23.) The common stock was to be issued and paid for in the following manner (R. 23-24):

One thousand (1,000) shares to each of the above named persons in part consideration of the execution and fulfillment of the contract pertaining to the exploiting, marketing, distributing and turning to account of his or her motion pictures with the said corporation. The details concerning the delivery of the aforesaid common shares of stock to each of the aforesaid

persons shall be more fully set forth in the agreement between said person and said corporation pertaining to the exploiting, marketing, distributing and turning to account the motion pictures produced by such person and included in such contract.

One thousand (1,000) shares to William G. McAdoo who is to become the General Counsel of said corporation.

All of the common stock was to be issued (R. 24)—

* * * subject to the right of the corporation for its then existing stockholders to repurchase the same in the event of such stockholder desiring to sell any portion or all of his or her shares of common stock in said corporation to any person who is now [sic—not] actively associated with such stockholder in the business of producing photoplays * * *.

The substance of this provision was included in the bylaws subsequently adopted by the corporation. (R. 24.)

On the same day the taxpayer signed a proposed distribution agreement which was subsequently executed by the corporation on June 13, 1919. Similar agreements were signed by Douglas Fairbanks, Mary Pickford and D. W. Griffith. (R. 24.) The agreement signed by the taxpayer provided, *inter alia*, that he would produce and deliver to the corporation nine photoplays of between 1,600 and 3,000 feet in length within three years from the date thereof. For its part the corporation obligated itself to give the taxpayer's name "chief prominence" in the advertise-

ments of his pictures, to use its best efforts to market the films upon a basis of sharing in gross receipts, and agreed that no franchise or territorial right for the use of such photoplays should be made without his written consent. (R. 24-25.) The contract further provided (R. 25):

And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto and to be held by said person until said artist delivers to said corporation, nine (9) photoplays. Should said artist be unable to deliver nine (9) such photoplays because of illness or incapacity during the said entire period of three (3) years, said artist shall receive so many of the aforesaid one thousand (1,000) shares of the common stock of this corporation as the number of photoplays delivered by said artist to this corporation pursuant to this agreement bears to the number of nine. The balance of the shares of such common stock shall be delivered by such escrow agent to this corporation.

This provision was amended by an agreement entered into between the four artists and the corporation on July 5, 1919, to provide (R. 27-28):

And in addition to the above consideration, one thousand (1,000) shares of the common stock of the said corporation to be issued in the name of the said Artist in the form of nine (9) certificates, eight (8) of which shall be for one hundred and eleven (111) shares each and

one of which shall be for one hundred and twelve (112) shares, said certificates to be delivered in escrow to a person or corporation to be agreed upon by the parties hereto. Upon delivery by the said Artist to the said corporation of each one (1) of the first eight photoplays called for by this contract, such escrow agent shall deliver to the said Artist one (1) of said certificates for one hundred and eleven (111) shares, and upon delivery by the said Artist to the said corporation of the ninth (9th) photoplay called for hereunder, such escrow agent shall deliver to the said Artist said certificate for one hundred and twelve (112) shares. Upon the expiration of the three-year period herein provided for, so many of said certificates as are then still held by such escrow agent in accordance with the provisions of this paragraph shall be delivered by such escrow agent to the said corporation.

On April 17, 1919, the certificate of incorporation of United Artists Corporation was filed with the Secretary of State of Delaware. It authorized the issuance of 5,000 shares of preferred stock, \$100 par value, and 9,000 shares of common stock. The preferred stock was to have no voting rights. Each holder of shares of common stock was entitled to as many votes at all elections of directors as his number of shares multiplied by the number of directors to be elected. (R. 24.)

On May 29, 1919, the board of directors of United Artists adopted the following resolution (R. 25-27):

Whereas in the judgment of the Board of Directors the photoplays agreed to be delivered

to this Corporation under said contracts are necessary for the business of this Corporation and constitute good and sufficient consideration for the issue of five thousand (5000) shares of the common stock of this corporation, the same being without par or nominal value:

Resolved that, in consideration of the delivery of said contracts to this Corporation the proper officers of this Corporation be, and they hereby are, authorized to issue and deliver to William G. McAdoo, Esq.,¹ one thousand (1,000) shares of no par value of this corporation fully paid and non-assessable, said shares to include the shares of no par value subscribed for by the signers of the certificate of incorporation of this Corporation, assignments of said subscriptions being held by him; and

Resolved that, in consideration of the delivery of said contracts of this Corporation, the proper officers of this Corporation be, and they hereby are authorized to issue to said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) one thousand (1,000) shares of no par value each, making a total of four thousand (4,000) shares of no par value to a person or corporation to be agreed upon by said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation, and to no other person, said four

¹ These shares were surrendered to the corporation by McAdoo in 1920, and subsequently in 1924, 1,000 shares were issued to Joseph M. Schenck. None of this stock was ever put in escrow. (R. 34.)

thousand (4,000) shares to be held by said person or corporation in escrow in accordance with the provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation; and

Resolved that the proper officers of this Corporation be, and they hereby are, authorized and directed to execute an escrow agreement for the holding and delivery of said four thousand (4,000) shares of non-par value in accordance with the terms and provisions of said contracts between said Charles Chaplin, Douglas Fairbanks, David W. Griffith and Gladys Mary Moore (professionally known as Mary Pickford) and this Corporation dated February 5th, 1919, said escrow agreement to provide that while said four thousand (4,000) shares are held in escrow, each of the aforesaid artists shall have the right to vote his or her respective holdings thereof; provided that said escrow agreement shall be approved by the general counsel of this corporation before execution of the same by its officers.

On June 9, 1919, the corporation issued nine certificates of stock—eight for 111 shares each and one for 112 shares—in which the taxpayer was shown as the owner. The certificates were not delivered to the taxpayer, but were kept in the possession of the corporation until subsequently delivered to the escrow agent in accordance with the agreement between the taxpayer and his associates and with the corporation. (R. 27.)

The following entry appears in the journal of the corporation (R. 27) :

June 9 [1919] Artists' Contracts.....	A-4	\$25, 000. 00
Consideration for contracts with the four artists for delivery of photoplays to Corporation as per resolution of Board of Directors adopted May 29, 1919 (ratified by stockholders, Sept. 9, 1919)		
Capital Stock—Common.....	C-7	\$25, 000
Issued 5,000 shares at no par value, but regarded to have a value of \$5.00 per share (verbal advice of General Counsel)		

On August 5, 1919, the taxpayer and the corporation entered into an agreement with one Dennis F. O'Brien. This agreement provided for the delivery by the corporation to O'Brien, as escrow agent, of nine certificates representing 1,000 shares of common stock and for the delivery by the depository of a certificate of deposit to the taxpayer, who was referred to as the Artist. (R. 28.) The agreement went on to provide (R. 28-30) :

* * * *

Third: Upon delivery by the Artist to the Corporation of each one (1) of the first eight (8) photoplays called for by the aforesaid contract, the Corporation shall notify the Depository in writing that the Artist is entitled to one (1) of said certificates for one hundred and eleven (111) shares, whereupon the Depository shall deliver one (1) of the same to the Artist upon surrender by the latter of the certificate of deposit herein provided for and shall issue to the Artist a new certificate of deposit, substantially in the form of that annexed hereto, in respect of the number of shares remaining in escrow. Upon delivery by the Artist to the Corporation

of the ninth (9th) photoplay called for by the aforesaid contract, the Corporation shall notify the Depositary in writing that the Artist is entitled to said certificate for one hundred and twelve (112) shares, whereupon the Depositary shall deliver the same to the Artist upon surrender by the latter of the certificate of deposit which he then holds. At the expiration of said period of three years, the Depositary shall deliver to the Corporation so many of the certificates deposited hereunder as then remain in escrow and are not the property of the Artist, and the Artist shall return to the Depositary the certificate of deposit which he then holds.

Fourth: Any and all dividends which may be declared upon the shares of stock represented by the certificates deposited hereunder while the same, or any part thereof, are held in escrow by the Depositary shall be deposited by the Corporation in the Central Union Trust Company, No. 80 Broadway, New York City, in an account to be known as "United Artists Corporation, Trust Account No. 1." Upon delivery to the Artist by the Depositary, in the manner hereinbefore provided for, of each of the certificates deposited hereunder, the Corporation shall pay to the Artist one-ninth ($\frac{1}{9}$) of all dividends which at the time of such delivery shall have been deposited in said account, together with accrued interest thereon. At the expiration of said period of three years, so much of such dividends and interest thereon as remain in said account and are not due the Artist shall become the property of the Corporation.

Fifth: The Depositary shall not have the right to vote the shares of stock deposited hereunder.

* * * * *

The certificate of deposit recited that O'Brien held the stock for the benefit of the taxpayer (who was referred to therein as the "Beneficiary") and that delivery of the stock or portions thereof would be made to the taxpayer upon the receipt by the depositary of written notice from the corporation that the taxpayer was entitled thereto under the terms of his agreement with corporation. The certificate of deposit also stated that the holder thereof "shall have the same voting rights as a holder of a regular certificate of common stock of United Artists Corporation." (R. 30.)

The taxpayer did not deliver any motion pictures to the corporation during the three-year period referred to in the contracts, nor had any of the parties delivered all of the nine pictures referred to in their contracts with the corporation. Although the agreements were not modified to extend the three-year period for the delivery of the pictures, all of the parties continued to treat the agreements as in full force and effect, and none of the stock held in escrow was redelivered to the corporation. In 1923 the taxpayer delivered to the corporation one motion picture and received from the escrow agent one certificate for 111 shares of stock. This left eight pictures undelivered and eight certificates of stock still held by the escrow agent. (R. 30-31.)

On November 22, 1924, the taxpayer, Mary Pickford, Douglas Fairbanks, Joseph Schenck and the corporation entered into an agreement further modifying the distribution agreement of February 5, 1919. It recited that "Miss Pickford, Chaplin, Fairbanks and Griffith are the owners of all of the preferred and common stock of the corporation, now issued and outstanding" except certain qualifying shares. It provided that Miss Pickford and Fairbanks would produce by November 1, 1928, designated numbers of pictures in addition to the nine each had originally promised, but neither of them was to receive any additional common stock. (R. 31-32.) It further provided for the reduction of the taxpayer's remaining quota of eight pictures to five, to be delivered, one each year, by January 1, 1929, and stated (R. 32):

The balance of the common stock of the corporation, which is now held in escrow for the benefit of Chaplin shall be delivered to him in the proportion of one fifth ($\frac{1}{5}$) thereof upon the delivery of each motion picture photoplay by Chaplin to the corporation.

The taxpayer delivered to the corporation one picture in 1925 and another in 1928. In the latter year new certificates were issued by the corporation in place of the old ones, the taxpayer receiving three certificates for a total of 499 shares and O'Brien, the escrow agent, receiving three certificates for a total of 501 shares. In 1931 the taxpayer delivered another picture and received from the depository a certificate for 167 shares. All of the pictures delivered by the

taxpayer to the corporation were much longer than the 1,600 to 3,000 feet specified in the agreement. (R. 32, 33.)

On September 20, 1935, an agreement was entered into between the taxpayer and the corporation under which the remaining two certificates (Nos. 87 and 88, each for 167 shares) were released to the taxpayer, together with accumulated dividends thereon in the sum of \$44,532.22, which had been paid to the escrow agent during the years 1930 to 1934. The dividends had been deposited in a special bank account and interest on the deposits in the amount of \$995 was paid to the taxpayer when the stock and dividends were released. This amount was included in gross income in the taxpayer's income tax return for 1935. (R. 33-34.)

When the original nine certificates totaling 1,000 shares of stock were put in escrow, the taxpayer did not sign them. When these certificates were canceled by the corporation and six certificates totaling 1,000 shares were issued in their stead, and placed in escrow, the taxpayer signed these six certificates in blank. (R. 34.)

After the organization of the corporation, the taxpayer attended stockholders' meetings, voted at such meetings for directors and otherwise, received notices and signed proxies the same as any stockholder. He was carried on the books of the corporation as the owner of 1,000 shares of common stock. The dividends upon the stock standing in his name were deposited in a trust account in a New York bank in accordance with the escrow agreement. (R. 34.)

The taxpayer did not include the value of the 334 shares of United Artists stock in his income tax return for 1935. The item of \$44,532.22 which the taxpayer received on September 20, 1935, together with the stock certificates, was reported but was treated by the taxpayer as a dividend, and therefore not subject to the normal tax. The Commissioner determined that the 334 shares of stock constituted income in the year 1935, in the amount of \$104,709 which he determined to be the fair market value. The Commissioner also determined that the item of \$44,532.22 did not represent "dividends" received in the taxable year, but was to be treated as ordinary income, and therefore subject to the normal tax. (R. 10-13, 34-35.) The Board of Tax Appeals held (1) that the United Artists' stock constituted income in 1935, and (2) that the item of \$44,532.22 was "received as dividends from a domestic corporation" within the meaning of Section 25 (a) (1) of the Revenue Act of 1934, and therefore not subject to normal tax. One member dissented from the holding upon the first point and one member dissented from the holding upon the second point. (R. 35-45.) The taxpayer seeks review upon the Board's decision on the first point, and the Commissioner seeks review of the Board's decision upon the second point.

STATEMENT OF POINTS TO BE URGED BY COMMISSIONER

The Commissioner's assignments of error, all of which are here relied upon, appear in the Record at pages 335-337. They may be summarized by the

simple statement that the Board erred in holding that the item of \$44,532.22 was not subject to normal tax.

SUMMARY OF ARGUMENT

I

The Board correctly decided that the 334 shares of United Artists stock constituted income to the taxpayer in 1935. The taxpayer's contention that he became the owner of the stock in 1919 is in the teeth of the unequivocal terms of the contracts under which his rights were derived. The clear terms of all of the agreements among the parties permit of no conclusion other than that the taxpayer was to receive the stock only in consideration of the delivery by him to the corporation of the promised photoplays. He was *not* to get the stock *unless and until* he delivered the pictures. The elaborate escrow agreement was devised for this very purpose and loses most of its significance if it be construed otherwise than in accordance with its plain language.

Insofar as the taxpayer's contention rests upon the evidence outside of the contracts, it constitutes essentially an attempt to have this Court determine where the preponderance of the evidence lies. The testimony of the witnesses and the various exhibits were, at best, but evidentiary in value. What inferences were to be drawn from that evidence and the weight to be accorded those inferences were for the Board to determine. The scope of the review extends only to a determination of whether the record compels a conclusion contrary to that reached below. Moreover

there is really no inconsistency between the contracts and the evidence relied upon by the taxpayer.

It is unnecessary to determine in this proceeding whether the stock was issued at all by the corporation prior to 1935; or, if it was issued, whether it had been lawfully issued. For, regardless of how those points might be decided, we think it must be held that for income tax purposes the taxpayer was required to account for the stock in 1935.

II

The item of \$44,532.22 is not free from normal tax since it was not a dividend within the meaning of Section 25 (a) (1) of the Revenue Act of 1934. Despite the designation of the item as "accrued dividends", the corporation did not irrevocably part with the money at the time of declaration. The taxpayer was in exactly the same position with respect to this item as he was with respect to the stock. Although the corporation did part with the money in 1935, when it was turned over to the taxpayer, the item at that time no longer constituted a dividend. It merely represented part of the contractual compensation for the performance of the distribution agreement.

ARGUMENT

I

The Board correctly decided that the 334 shares of United Artists stock constituted income to the taxpayer in 1935

Introduction: The issue upon this branch of the case arises out of the Commissioner's determination,

and the Board's affirmance thereof, that the taxpayer was required to account in the year 1935 for the 334 shares of United Artists stock represented by the certificates numbered 87 and 88.

The Board of Tax Appeals resolved the issue by determining that the taxpayer was not the owner of the shares prior to their delivery to him in 1935. The taxpayer contends that he became the owner of the stock in 1919.² Insofar as this contention turns upon the terms of the various agreements under which the stock was issued, we submit, and shall show, *infra*, that the contention is patently erroneous. Insofar as the taxpayer's argument is based on the contention that evidence *aliunde* the contracts establishes that it was the intention of the parties that the taxpayer was to acquire complete ownership of the stock in 1919, the argument consists essentially of an attempt to have this Court reweigh the evidence which was considered by the Board. The Board has found, upon a consideration of all the evidence, that (R. 38):

* * * it was the intention of the parties that ownership of the stock should not pass to petitioner until and unless he "fulfilled" the terms and conditions of his contract and de-

² It seems to be agreed that for purposes of the federal revenue law the value of the stock became taxable income when the taxpayer first received the substantial incidents of ownership. Such incidents of ownership necessarily depend upon local law, but they do not depend upon the labels or terms which local law may apply. Thus, even assuming, solely for the sake of argument, that under local law the taxpayer were momentarily vested with "legal title" in 1919 or at all times since 1919 were regarded as the holder of "legal title", this would not be determinative. See, e. g., *Morgan v. Commissioner*, 309 U. S. 78, 80-81.

livered to the corporation the photoplays stipulated therein.

We think it important to make this point at the outset, for the taxpayer's argument is keyed to a fundamentally erroneous approach; it misconceives the nature of the question before this Court. Of course the Board's decision in the instant case is subject to review here, but it must be constantly borne in mind that the scope of the review does not extend to a re-trial of the case. The basic question presented to the Board was the determination of whether the taxpayer had subordinated the burden of proving that he was not required to account for the United Artists stock in the year 1935. In resolving this question the Board considered the language of the contracts and the sum of all of the other evidence in the case, both documentary and oral. To reach a conclusion, the Board was required to place in the balances the various items of proof, to assign to them relative values, to draw inferences from them and to assay the value of those inferences, both qualitatively and quantitatively. But that function having been exercised by the Board, that phase of the controversy is no longer open; the scope of the review does not extend to a re-evaluation of the evidence. Therefore, the question before this Court is fundamentally different from that which faced the Board of Tax Appeals. The issue here is whether the evidence *requires* a conclusion contrary to that which was reached below. *Wilmington Trust Co. v. Commissioner*, 316 U. S. 164; *Helvering v. Kehoe*, 309 U. S. 277; *Bank of California v. Commissioner* (C. C. A.

9th), decided January 29, 1943, not yet officially reported.

Of course the Board's decision may be reversed if there is a lack of substantial evidence to support it. But it may not be reversed upon a consideration of the preponderance of the evidence, or even if it is concluded that there is substantial evidence in support of the taxpayer's view of the case. The issue here is whether the evidence *compels* a conclusion contrary to that reached by the Board.

Despite this well-settled rule the taxpayer's brief approaches the question as though this Court were free to determine where the preponderance of the evidence lies. Thus, reliance is placed upon a series of exhibits (Br. 29), which, it is contended, indicate that the corporation treated the taxpayer as the owner of the stock prior to 1935. Stress is placed on the testimony of O'Brien (Br. 20, 35-36, 42-44) and on that of the taxpayer (Br. 34-35), as though such testimony were conclusive. But it is fundamental that the Board is not obliged to give such treatment to testimony (*Helvering v. Nat. Grocery Co.*, 304 U. S. 282, 295; *Bank of California v Commissioner, supra*), especially where, as here, the testimony conflicts with written contracts under which the rights of the parties are derived. Moreover, the taxpayer's recollection was exceedingly vague (R. 321) and O'Brien testified mainly in terms of the ultimate conclusion which the Board itself had to reach. (See the excerpt in the taxpayer's brief, pp. 42-44.) The various exhibits consisting of proxies, minutes of stockholders' meetings, journal entries in the corporation's

books, stock certificates, and the like, were, of course, evidentiary in value, but in no sense could they be deemed to have conclusive effect upon the fundamental issue in the case. We submit that upon the record made in the instant case it cannot be said that a conclusion contrary to that reached below is compelled. Indeed, although it is unnecessary that we go that far, we submit that the record could hardly support a contrary conclusion.

1. The agreements pursuant to which United Artists was formed and under which the taxpayer undertook to deliver to the corporation motion pictures for marketing and distribution are so clear as to permit of no doubt as to their meaning. The very first agreement, that of February 5, 1919, which provided for the formation of the corporation, provided that the rights of the parties to the common stock of the corporation were to depend upon the agreements relating to the marketing and distribution of the motion pictures which it was contemplated they would produce. The first of these distribution agreements entered into by the taxpayer was executed on the same day on which the parties contracted for the formation of the corporation. It states unambiguously that the common stock was to be held in escrow, and was not to be delivered to the taxpayer except as he delivered to the corporation the promised photoplays. It is significant that the agreement anticipated the contingency that illness or incapacity might have prevented the taxpayer from delivering the required number of photoplays, it being specifically provided that, in that event, the taxpayer was to receive only a proportion-

ate number of shares of the common stock held in escrow, and the balance of the stock was to be delivered by the depositary to the corporation. The amendment of this provision, made by the agreement of July 5, 1919, provides even more precisely that the taxpayer was to get the stock only upon delivery of the promised motion pictures. The 1,000 shares of stock were to be divided into nine certificates, all to be held in escrow. One certificate was to be released to the taxpayer for each photoplay delivered to the corporation, and at the end of the three-year period the balance of the certificates still held by the depositary were to be delivered to the corporation. The resolution of May 29, 1919, authorizing the issuance of the 1,000 shares of stock also carefully provided that the stock was to be held in escrow, and was to be delivered to the artists only in accordance with the provisions of their distribution contracts with the corporation. The escrow agreement of August 5, 1919, also states in clear language that the stock was to be delivered to the taxpayer only as he delivered the promised pictures. It is especially to be noted that this contract states (R. 29):

At the expiration of said period of three years the Depositary shall deliver to the Corporation so many of the certificates deposited hereunder as then remain in escrow *and are not the property of the Artist*, and the Artist shall return to the depositary the certificate of deposit which he then holds. [Italics supplied.]

This is a clear recognition that the stock was not to become the property of the artist until delivered to

him by the depositary. In addition, the expenses of the depositary were paid by the corporation, not by the taxpayer. (R. 147, 234.)

The escrow agreement of August 5, 1919, also makes it plain that the taxpayer was not to be entitled to any dividends upon any stock not released from escrow. Article Fourth provides specifically that any dividends declared upon the stock held in escrow were to be held under the same terms as those which related to the holding of the stock. The taxpayer was to receive those "accrued dividends" upon each of the certificates as he received the certificates, but he was to receive neither those "accrued dividends" nor the certificates unless he performed his distribution contract.

When the arrangement among the parties was modified on November 22, 1924, the agreement then entered into also carefully provided that the common stock then held in escrow for future delivery to the taxpayer was only to be delivered to him as he delivered the promised motion pictures to the corporation.

Thus, throughout all of the negotiations and throughout all the agreements among the parties there was a sharp distinction between the preferred stock of the corporation and the common stock. The preferred stock was to be subscribed to at the outset for cash and was to be redeemed as soon as practicable. The obvious purpose of this arrangement was to finance the corporation during its initial years. Thereafter all of the interests in the corporation were to be

represented by the common stock. Great care was taken, however, to make certain that each of the artists would make equal contributions to the corporation in the motion pictures which were essential to the success of the enterprise. None of the parties was to benefit beyond the extent to which he contributed to that success. Indeed, even the agreement of November 22, 1924, under which the taxpayer's remaining quota of pictures was reduced from eight to five, was based upon the same underlying thought. The measure of the taxpayer's obligation was fixed so as to require him to deliver pictures which grossed an amount equal to that represented by the pictures delivered by the other artists. (R. 215.)

The taxpayer contends (Br. 20-21, 41-48) that under these agreements he became the complete owner of the stock in 1919, when the first agreements were executed, and suggests that, pursuant to an "independent contract", the stock and the dividends thereon were held as security for performance by him of the distribution agreement. The plain fact of the matter is, however, that there was no independent contract, and that it was of the very essence of the entire arrangement that the taxpayer was not to become the owner of the stock until he delivered the promised photoplays. All of the documents relating to the issuance of the common stock were carefully drawn so as to provide that the taxpayer was *not* to receive the stock *unless and until* he delivered the pictures.

We think it is significant that the stock was placed in escrow under an elaborate arrangement, precisely detailed. The term "escrow" is a word of art, having

a definite meaning. It is fundamental that the rights of a transferee under a deposit in escrow do not vest until the depository makes a proper delivery of the property to him. The transfer is not complete until performance of the condition upon which it is to take effect. That is the essential meaning of the term, and is the meaning which obtains both in New York and in California.³ The point was stated succinctly by Chief Justice Kent in *Jackson v. Catlin*, 2 Johns 248, 259 (N. Y.) in the following language:

A deed is delivered as an *escrow* when the delivery is conditional, that is, when it is delivered to a third person, to keep until something be done by the grantee; and it is of no force until the condition be fulfilled.

See also *Fargo v. Burke*, 262 N. Y. 229, 186 N. E. 683.

Section 1057 of the Civil Code of California provides:

A grant may be deposited by the grantor with a third person, to be delivered on performance of a condition, and on delivery by the depository, it will take effect. While in the possession of the third person, and subject to condition, it is called an escrow.

See also *In re Reed*, 204 Cal. 119, 266 Pac. 948.

³ The contract of February 5, 1919 (R. 114-139), provides (R. 137) that it shall be construed and enforced according to the law of New York. It appears (R. 137-139) to have been executed by the taxpayer in California, and by United Artists in New York. The amendment thereto of July 5, 1919 (R. 140-141), and the escrow agreement of August 5, 1919 (R. 143-147) contain no such provision and it is not shown where they were executed. The contract of November 22, 1924 (R. 149-165), recites that it was executed in New York.

Moreover, it is to be noted that in the instant case it was expressly provided that the stock should never be delivered to the taxpayer to the extent that he failed to perform.

We submit that it is a patent distortion of the very essence of the agreements to construe them as though they had provided for the immediate delivery of the stock to the taxpayer, and a pledge of that stock by the taxpayer to secure his performance of his contractual obligations. The taxpayer never had sufficient dominion over the stock in order to pledge it as security. Until performance by him of his contract and delivery to him by the depository of the stock, there was never a moment of time when he had any freedom of action concerning it.

Furthermore, the elaborate escrow agreement loses most of its significance if it is viewed as a mere security device. If that were the true meaning of the arrangement the taxpayer would have been in a position to relieve the stock of the burden of the pledge by paying damages for any breach of performance. This would certainly not have satisfied the repeatedly expressed intention of the parties, for the success of the enterprise depended entirely upon the availability to the corporation of photoplays produced by the then leading people of the industry. And it is to be further noted that the arrangement was needlessly complex as a security device. A simple pledge, or, since the stock was restricted against alienation (R. 90, 107, 111-112), even a simple contractual provision would have sufficed for that purpose. Indeed, the taxpayer appears to have conceded this point. (Br.

48.) The escrow arrangement does have significance, however, and indeed was necessary, if the words of the agreements are read according to their plain meaning—the taxpayer was not to get the stock except as compensation for the performance of his contract. In the light of the clear words of these agreements we submit that there can be no adequate basis for a reversal of the Board's decision upon this branch of the case. *Southern Power & Mfg. Co. v. Commissioner*, 82 F. 2d 104 (C. C. A. 5th).

2. It is contended by the taxpayer and reiterated throughout his brief, that he enjoyed and exercised all of the incidents of ownership of the stock while it was in escrow. We submit that there is no basis for that contention and, that, on the contrary, it is clear that the taxpayer did not enjoy the fruits of ownership of the stock during that period. The only right normally associated with the ownership of stock which the taxpayer had during that time, was the right to vote. Although the right to vote is one of the usual incidents flowing from the ownership of stock, the existence of that right is certainly not a sufficient basis upon which to predicate a conclusion of ownership. As the Board pointed out (R. 39), the right to vote may be conferred by contract upon, and is frequently exercised by, persons having no beneficial ownership of stock in the corporation. *Alger-Sullivan Lumber Co. v. Commissioner*, 57 F. 2d 3 (C. C. A. 5th). The stockholders of a corporation may agree among themselves that a person who is not a stockholder shall have a voice in the management of the corporation, and since in the instant

case the corporation was a close one formed to carry out a purpose in which all of the parties were greatly interested, the arrangement is not surprising. There is, therefore, no necessary inconsistency between a conclusion that the taxpayer did not become the owner of the stock until it was released from escrow and the fact that he was entitled by contract to participate in the management of the corporation prior to that time.

In any event it is clear that under the express terms of the contract the taxpayer was denied the most fundamental of the fruits of ownership of stock, namely, the right to receive dividends thereon. For dividends declared upon the stock while it was in escrow were, like the stock itself, to be delivered to the taxpayer only upon performance by him of his obligations under the distribution agreement, and in the event of nonperformance, were to be returned to the corporation. Indeed, as we shall attempt to show under point II, *infra*, the amounts denominated "dividends" were not true dividends but really represented additional contractual compensation. We do not believe it to be of any significance that the compensation under the contract also included interest upon these amounts, especially since the interest was paid by the bank in which they were deposited and not by the corporation. (R. 306-307.)

The taxpayer also contends that he was considered to be the owner of the stock by the corporation at all times after 1919. The argument is based upon a series of exhibits consisting of minutes of the corporation,

proxies, journal entries on the corporation's books, and the like, which refer to the taxpayer as the owner. But of course the label which the parties placed upon the relationship is not conclusive of the nature of that relationship,⁴ nor are the book entries of the corporation more than evidentiary in value.⁵ Since, under the agreement among the organizers of the corporation, the taxpayer was permitted to vote while the stock was in escrow, it was not unnatural to describe him in notices of meetings, in proxies and in the minutes of the corporation as a stockholder. However, no issue ever arose between the taxpayer and the corporation in which it became necessary to determine whether or not he really owned the stock. The issue might have arisen if, for example, the taxpayer had died while the stock was in escrow. The stock could not have passed as part of his estate for the condition upon which it was being held had not been fulfilled. And since the distribution contract was personal, especially insofar as the taxpayer's performance was concerned (R. 130, 131), the condition could never be performed, and the personal representative could therefore never acquire the stock. In any event the

⁴ "The label counts for little." *Stearns Co. v. United States*, 291 U. S. 54, 61. See also *Helvering v. Richmond, F. & P. R. Co.*, 90 F. 2d 971 (C. C. A. 4th); *Bakers' Mutual Coop. Assn. v. Commissioner*, 117 F. 2d 27 (C. C. A. 3d); *Leland v. Commissioner*, 50 F. 2d 523 (C. C. A. 1st); *Johnson Locke Mercantile Co. v. Burnet*, 51 F. 2d 434 (App. D. C.)

⁵ *Helvering v. Midland Ins. Co.*, 300 U. S. 216, 223; *Doyle v. Mitchell Brothers Co.*, 247 U. S. 179, 187. "The bookkeeping creates nothing." *Sitterding v. Commissioner*, 80 F. 2d 939, 941 (C. C. A. 4th).

various exhibits were but evidence. They certainly were not conclusive, especially in view of the clear terms of the contracts.

It is also suggested (Br. 49 *et seq.*) that the terms of the distribution agreement were abandoned both by the corporation and by the taxpayer. The short answer to this contention is that it is not shown how, if there were such an abandonment, it operated in any way to ripen the taxpayer's interest in the stock. Moreover, the contract specifically provides (R. 129):

The parties hereto agree that any waiver by said artist or the corporation of any breach of any kind or character whatsoever by the other, whether such waiver be direct or implied, shall not be construed as a continuing waiver of, or consent to, any subsequent breach of this contract on the part of the other, and particularly as regards the making and delivery of the statements and of the keeping of the accounts, and of the delivery of the photoplays herein provided.

* * * *

3. It is contended by the taxpayer that he acquired the stock in 1919 in consideration of the execution by him of the distribution agreement, and that the ripening of his right to the stock did not depend upon performance of that agreement.⁶ In this connection it is argued that under Section 3 of the Delaware Cor-

⁶ Under the taxpayer's theory all of the stock would have constituted taxable income to him in 1919. But the taxpayer introduced no evidence to show that he had accounted for the stock in his return for that year, nor does it otherwise appear from the record that he did so.

poration Law the corporation could not have issued the stock except for property received; that the corporation could not have issued the stock to itself and unless someone other than the corporation owned it, no dividends could have been declared upon it; that the depositary did not own it; and that it therefore follows that ownership of the stock was vested in the taxpayer. It is to be noted that the fundamental premises upon which all of these propositions are based are: (1) That the stock was actually issued by the corporation while it was held by the depositary, and (2) that if it was issued, the action of the corporation in so doing was proper. We do not believe it would be helpful to enter into an extended discussion upon these points. Should the issue have arisen in some other connection it might very well have been held that the correct analysis of the entire transaction is that the stock here involved was not really issued in any sense prior to 1935. It is true that certificates were prepared by the corporation, but the mere preparation of certificates does operate to constitute the person named therein as the owner of any stock. If it should be assumed that for some purposes the stock would be considered as having been issued prior to 1935, it by no means follows that it was lawfully issued within the meaning of Section 3 of the Delaware Corporation Law. Certainly the action of the corporation in declaring so-called "dividends" upon this stock would not prove either (a) that the stock was issued at all, or (b) that, if it was issued, it had been done so lawfully. The important point is that

in the instant case it is unnecessary to decide any of these questions. It is completely immaterial whether for the purpose of satisfying Section 3 of the Delaware Corporation Law it might be held that the consideration for the issuance of the stock was the execution of the distribution agreement.

Regardless of how those points might be decided we think it clear that the taxpayer was required to account for the stock for income tax purposes in 1935. *Olson v. Commissioner*, 24 B. T. A. 702, affirmed, 67 F. 2d 726 (C. C. A. 7th), certiorari denied, 292 U. S. 637; *Stiver v. Commissioner*, 90 F. 2d 505 (C. C. A. 8th); *Big Lake Oil Co. v. Commissioner*, 95 F. 2d 573 (C. C. A. 3d), certiorari denied, 307 U. S. 638; *Silberblatt v. Commissioner*, 28 B. T. A. 73. In the *Olson* case, *supra*, a corporation agreed to compensate its officers with stock in the corporation in consideration of their remaining in the employ of the company. The stock was issued annually to a trustee for five years and at the end of that period was turned over to the officers by the trustee, but the officers were entitled to and did receive all dividends on all of the stock in the interim. It was held that all of the stock was income in the last year when it was received from the trustee.

In the *Silberblatt* case, *supra*, the taxpayer entered into a contract in 1925 for the sale of stock at a price less than its cost. Part of the purchase price was paid in 1925 but the balance was not due until 1926. The stock was placed in escrow to be delivered to the purchasers upon payment of the balance, and to be

returned to the vendor upon default in payment. The payment was completed and the stock was delivered to the purchasers in 1926. It was held that the loss was not deductible in 1925, but was properly to be reflected in the return for 1926. The *Stiver* case, *supra*, presented a similar question and was similarly decided.

Big Lake Oil Co. v. Commissioner, supra, involved facts very much like those in the case at bar. There the taxpayer was engaged in producing oil and entered into an agreement with others to organize a pipe line company. As in the instant case, the working capital was to be furnished by means of preferred stock which was later to be retired. Under the agreement the taxpayer was entitled to common stock in the new corporation, but it was placed in escrow until the retirement of the preferred stock. It was held that the income represented by the stock was realized in the year in which the escrow was terminated.

In the instant case the taxpayer transferred nothing to the corporation in 1919 for the common stock and did not receive it then. He merely entered into a contract with the corporation under which he might receive it in the future. When the escrow was terminated he had for the first time unqualified and unconditional rights in the stock. Until that time he could not properly be said to have realized any income. *Cf. Lucas v. American Code Co.*, 280 U. S. 445; *Lucas v. North Texas Co.*, 281 U. S. 11; *North American Oil v. Burnet*, 286 U. S. 417; *United States v. Safety Car Heating Co.*, 297 U. S. 88.

The cases cited by the taxpayer do not support a contrary conclusion. Furthermore, even a squarely contrary Board decision would not constitute an authority for a reversal of its decision in the instant case (*Rogers v. Commissioner*, 103 F. 2d 790, 793 (C. C. A. 9th); *Hirsch v. Commissioner*, 124 F. 2d 24, 30 (C. C. A. 9th)), and we believe that the same thing may be said of the District Court decision in *Schneider v. Duffy*, 43 F. 2d 642 (N. J.). We point out, however, that there are vital distinctions between the cases relied upon by the taxpayer and the instant case. *Schneider v. Duffy*, *supra*, involved a contract under which a corporation promised to pay 1,500 shares of stock to one of its officers as part of his compensation. Although the certificates were delivered to him over a five-year period, the contract expressly provided that he was to receive all dividends on the entire 1,500 shares from the time of execution of the contract. As we have pointed out, in the instant case the taxpayer had no right to dividends on any stock held in escrow unless and until he performed his contract and became entitled to receive the stock. In addition it is to be noted that in *Schneider v. Commissioner*, 3 B. T. A. 920, the Board of Tax Appeals reached, upon the same facts, a result squarely contrary to that reached by the District Court in the *Schneider* case. The Board's conclusion was sustained in *Glenn v. Bowers* (S. D. N. Y.), affirmed, *Glenn v. Bowers*, 65 F. 2d 1017 (C. C. A. 2d), certiorari denied, 290 U. S. 681. See 1943 C. C. H., par. 53,111. See also *Olson v. Commissioner*, *infra*.

In *Hopkins v. Commissioner*, 41 B. T. A 1292, there was involved a contract for the sale of stock under which it was agreed that the stock was to be held by a bank until the purchase price was paid. It was provided, however, that all dividends declared upon the stock while it was held by the bank were to belong to the purchaser. The same thing is true of *Carnahan v. Commissioner*, 21 B. T. A. 93. *Ambassador Petroleum Co. v. Commissioner*, 28 B. T. A. 873, merely holds that delay by a corporation in preparing certificates does not necessarily mean that the stock had not been issued prior to preparation of the certificates. The case represents no more than an application of the general rule that certificates are but evidences of stock ownership.

We submit that this branch of the case has been correctly decided by the Board.

II

The item of \$44,532.22 is not free from normal tax since it was not a dividend within the meaning of Section 25 (a) (1) of the Revenue Act of 1934

In addition to the 334 shares of United Artists stock which the taxpayer received in 1935 from the depository, he also received the amount of \$44,532.22 which represented "accumulated dividends" which had been paid to the depository by the corporation in the years 1930 to 1934.⁷ These amounts had been kept by the depository in a special bank account. For the reasons which have been developed under

⁷ Interest on the deposit in the amount of \$995 was also paid to the taxpayer. No dispute arises concerning this item.

point I in this brief we think it clear that these "accumulated dividends" constituted income to the taxpayer in the year 1935. The further question, which is presented by the Commissioner's appeal, is whether this item constituted a dividend within the meaning of Section 25 (a) (1) of the Revenue Act of 1934, *supra*. That section grants a credit in the computation of the normal tax for amounts "received as dividends from a domestic corporation". The Board of Tax Appeals (one member dissenting) has held that the taxpayer is entitled to this credit. We submit that that holding is erroneous.

Under the terms of the contracts, which have already been discussed at length, and under the findings of the Board, the taxpayer was not entitled to the stock until he had performed his obligations under the distribution agreement. He was in exactly the same position with respect to the so-called "accrued dividends". At the time of declaration the corporation did not irrevocably part with any money. Moreover, the items could not have been dividends at the time of declaration, since by hypothesis the taxpayer was not a shareholder (insofar as the stock here involved is concerned) at that time, and Section 115 (a) defines a dividend as a "distribution made by a corporation to its shareholders". Although the corporation did part with the money in 1935, when it was turned over to the taxpayer, the item at that time no longer constituted a dividend. Under the terms of the agreements such items merely represented part of the contractual compensation for the photoplays produced by the taxpayer. A payment of money by a corpora-

tion under such circumstances does not constitute a dividend. *Weaver v. Commissioner*, 58 F. 2d 755 (C. C. A. 9th).

Similar questions were raised in *Curran v. Commissioner*, 49 F. 2d 129 (C. C. A. 8th) and *Thorp v. Commissioner*, 32 B. T. A. 767. See also *Mattis v. Becker* (E. D. Mo.), decided June 9, 1937 (19 A. F. T. R. 1331). *Cf. Mid-West Rubber Reclaim Co. v. Commissioner*, 131 F. 2d 156 (C. C. A. 7th). In the *Curran* case the issue raised was whether a payment by a corporation to its stockholders, which was denominated a dividend, was a true dividend or was really a payment for property purchased. The court said (p. 131):

When this statute seeks to tax income as derived from corporate dividends, obviously, it means income derived from corporate earnings which accrue to the stockholder *solely because of his relation as such to the corporation*. It has no design to so tax money paid to the taxpayer as the purchase price of property. The form is not conclusive evidence that the payment really and essentially and solely was a corporate dividend.

* * * * *

The payment was, except in bare form, no dividend, but it was really a payment for property purchased * * *. [*Italics supplied.*]

The *Thorp* case, *supra*, raised the exact question presented by the instant case. There the taxpayers, who were attorneys, entered into a contract to conduct litigation to obtain the recovery of certain shares of stock, their compensation to be ten percent of the

amount recovered. Pending the outcome of the litigation the stock was placed in escrow in the year 1926. In 1928 the litigation terminated and the attorneys received their portion of the stock, together with a portion of the dividends which had been declared thereon in the interim. With respect to the latter item the Board held that it was not free from normal tax, stating (p. 768):

When petitioners received it in 1928 it had lost its character as a corporate distribution and they received it only by virtue of their contract for services. To them it was compensation for services, and the Commissioner correctly treated it as such.

We submit that in the instant case the payments, however they might have been characterized when they were made to the depository, were not dividends within the meaning of Section 25 (a) (1) when they were received by the taxpayer in 1935.

CONCLUSION

The decision of the Board of Tax Appeals should be affirmed on the taxpayer's appeal and reversed on the Commissioner's appeal.

Respectfully submitted,

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